ANNUAL REPORT 2004/05

FINANCIAL REPORTING COUNCIL

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Financial Reporting Council

Annual Report 2004/05

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The Financial Reporting Council Limited

(a company limited by guarantee)

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Introduction

The FRC's aim is to promote confidence in corporate reporting and governance. This report sets out what we did in 2004/05 to contribute to that aim. It includes our audited accounts.

On 1 April 2004, we became the UK's unified independent regulator for corporate reporting and governance, with the following functions:

- setting, monitoring and enforcing accounting and auditing standards
- statutory oversight and regulation of auditors
- operating an independent investigation and discipline scheme for public interest cases
- overseeing the regulatory activities of the professional accountancy bodies
- promoting high standards of corporate governance

Our responsibilities were widened to include new activities, including setting and monitoring auditing standards, and deepened to undertake existing tasks, such as the enforcement of accounting standards, more intensively.

Our functions are exercised by our operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Professional Oversight Board for Accountancy, the Financial Reporting Review Panel and the Accountancy Investigation and Discipline Board) and by the Council.

Our Regulatory Strategy explains our structure, the role of the Council and our operating bodies, and our governance, funding and accountability. It sets out our five key objectives, which are to promote:

- high quality corporate reporting
- high quality auditing
- high standards of corporate governance
- the integrity, competence and transparency of the accountancy profession
- our effectiveness as a unified independent regulator

Our Strategy, our Plan & Budget for 2005/06 and details of our work, including our publications, are available on our website at: *www.frc.org.uk.*

Our approach to our work

The FRC is a "market-led" regulator. We believe in wealth creation, and that our role in promoting corporate reporting and governance can make the creation of wealth more likely. We have developed a regulatory philosophy that commits us to:

- working on the basis that a well-informed market is the best regulator
- targeting the use of our powers, taking a proactive, risk-based and proportionate approach and making effective use of regulatory impact assessments
- emphasising principles and clarity in our standard-setting and rule-making
- being consultative - involving preparers, auditors, users of corporate reports and other regulatory bodies in our decision-making and allowing adequate time for consultation, without compromising our independence or confidentiality
- actively helping to shape EU and global approaches to accounting, auditing and corporate governance in ways that contribute to international confidence in corporate reporting and governance and to wealth creation
- being transparent, accountable and efficient in our work, and ensuring that it receives appropriate publicity

Part Two of this report sets out the way in which we have sought to follow these principles in pursuit of our objectives.

The Council

The Council has a key role in providing guidance to the FRC and its operating bodies. It has wide and balanced representation from the business, investor, professional and other communities with an interest in corporate reporting and governance. The Council played an important role in developing our Regulatory Strategy and the regulatory philosophy that underpins it.

The Council met four times during the year. It received progress reports from the Chairs of the operating bodies at each meeting, and reviewed developments in a number of areas, including:

- international accounting standard-setting
- the operating and financial review
- developments in the enforcement of accounting standards
- the regulation and quality of audit
- the adoption of international standards on auditing
- the establishment of ethical standards for auditors
- the review of the Combined Code on Corporate Governance
- the development of the Accountancy Investigation and Discipline Board Scheme and its Case Costs Agreement

There have been a number of changes to the membership of the Council during the year. Sir John Egan, David Illingworth, Scott Bell, Sir John Bond, Martin Broughton, Michael Foot, Stephen Haddrill, Richard Pearson and Sir Andrew Likierman (an observer) have left the Council. Mary Keegan left the Council on her appointment as Managing Director, Government Financial Management at HM Treasury, but has become an observer in that capacity. I thank most warmly all those who have left the Council for their contribution and welcome the new members: Paul Boyle (Chief Executive), Tim Breedon (also a Director of FRC Ltd), Baroness Sarah Hogg, Ian Mackintosh (as Chair of the ASB in succession to Mary Keegan), Sir George Mathewson, Ian Robertson, Hector Sants, John Sunderland (also a Director of FRC Ltd), Lindsay Tomlinson, Anthony Watson and (as observers) Dr Clive Grace, Ian Michael and Ian Morris.

The membership of the Council is shown in Annex B.

Our main goals in 2004/05

We set ourselves three main goals for the year:

- establishing our credibility in our wider and deeper role by completing effectively the first year tasks we set ourselves
- making the FRC more than the sum of its parts by exploiting the synergies between the different parts of the FRC
- ensuring that the FRC has adequate resources and management processes

Establishing our credibility in our wider and deeper role

The most important way in which we have sought to establish our credibility in our new role has been through effective delivery by the operating bodies of their responsibilities. Section Two of this report sets out our achievements under our five objectives; this section summarises the key issues seen from the perspective of the operating bodies.

The Accounting Standards Board (ASB)

The ASB's work during the year was dominated by the international standard-setting agenda. From the start of 2005 listed companies in the UK and the Republic of Ireland must use EU-adopted IFRS to prepare their group financial statements, in place of UK accounting standards. Listed companies are permitted to use IFRS in their individual accounts. Other companies are also permitted to use them in their group and individual accounts.

The ASB contributed to the development of IFRS, working with the IASB and other national standard-setters. The ASB also influenced EU policy on accounting standards, including the adoption of IFRS. Of the 36 international accounting standards which are mandatory from 1 January 2005 all but one have been adopted without amendment for use in the EU. The exception is IAS 39 'Financial Instruments: Recognition and Measurement', where the Commission has adopted an amended version, with 'carve-outs' that affect two parts of IAS 39: the hedge accounting requirements and the so-called 'fair value' option. The ASB expressed its concern about this partial endorsement and, in December 2004, issued guidance for UK companies following EU-adopted IFRS to help them understand the implications of the amended fair value option for their 2005 reporting. Good progress has been made in resolving the fair value option carve-out.

In considering its proposals for adoption, the Commission receives advice from European Financial Reporting Advisory Group (EFRAG). The former Technical Director of the ASB was a member of EFRAG's Technical Expert Group throughout 2004-05 and the ASB Chairman is an ex-officio observer. The ASB has played a major role in a number of working groups set up by EFRAG, in particular those dealing with measurement, revenue recognition and service concession arrangements.

The ASB has been considering its future role in the light of international and EU developments and, in March 2005, issued an Exposure Draft of a Policy Statement 'Accounting Standard-setting in a Changing Environment: The Role of the Accounting Standards Board'. It sets out, for consultation, the ASB's views on its future role. The ASB believes that it has an important part to play in the new environment and will continue to have an influential role in the development of accounting standards. The Exposure Draft seeks views on the ASB's priorities, including its approach to convergence between UK standards and IFRS.

While the international dimension is clearly central to its work, the ASB also retains important domestic responsibilities. The ASB published seven UK standards based on IFRS during the year. The Exposure Draft proposes that the ASB will continue its work to bring about convergence between UK standards and IFRS - adopting UK standards based on IFRS with no changes other than those that are essential or justifiable.

During the year, the ASB issued a major new standard on life assurance accounting (FRS 27). This followed a request from HM Treasury to carry out an urgent study into the accounting for with-profits business by life assurers, in the light of the issues raised by the Penrose Report on Equitable Life. The ASB established an Advisory Panel on With-Profits Life Assurance, which was chaired by Julian Hance. (The membership of the Panel is shown in Annex B.) Developing the new standard proved difficult and controversial, but the Board worked successfully with the industry to develop a standard which will make a major contribution to improving the financial reporting of entities with life assurance business.

The ASB faced a further important challenge during the year, following the Government announcement that the ASB would be the body responsible for setting reporting standards on the OFR. In November 2004, the ASB issued RED 1 'The Operating and Financial Review', which built on the ASB's previous statements and set out the requirements for an OFR, which for quoted companies are mandatory for financial years beginning on or after 1 April 2005. In developing RED 1, the Board took advice from its OFR Advisory Committee. (The membership of the Committee is shown in Annex B.) The final Reporting Standard was published on 10 May 2005. This work has attracted considerable media and commentator interest and will no doubt continue to do so as it moves into the implementation phase.

There have been a number of changes in the membership of the ASB during the year. Mary Keegan stepped down as Chair and became an observer. She was only the second Chair of the ASB, and our particular thanks go to her for her contribution. Douglas Flint and Huw Jones stood down as members. Allan Cook and Sir Andrew Likierman stood down as observers. My thanks for the contribution they have made to the work of the Board, and my welcome to Ian Mackintosh, who became the new Chair of the ASB on 1 August 2004, and to Anthony Good and Peter Westlake who joined the Board.

Auditing Practices Board (APB)

Since its inception APB has worked towards the strengthening of auditing standards. In recent years, rather than doing this in isolation, it has contributed to the work of IAASB on international harmonisation of auditing standards. During 2004 an important milestone in this process was achieved. APB issued a complete new suite of ISAs (UK and Ireland) which comprise ISAs as issued by the IAASB supplemented where necessary by existing UK standards and guidance. ISAs (UK and Ireland) apply to all audits of financial statements for periods commencing on or after 15 December 2004.

As a result of its post-Enron review of audit and accounting issues the Government concluded that APB should take responsibility for setting standards for the independence, objectivity and integrity of auditors (“ethical standards”). In November 2003 APB issued exposure drafts of five new ethical standards for auditors. In developing these exposure drafts APB took account of international developments, including the requirements of the EU Recommendation on the independence of statutory auditors. In October 2004 APB finalised these ethical standards and at the same time issued an exposure draft of a further standard on exemptions available for small entities, which was finalised in December 2004 as 'ES - Provisions Available for Small Entities'. All of the standards are effective for audits of financial statements for periods commencing on or after 15 December 2004.

The regime under which reporting accountants perform their work on investment circulars is undergoing significant change. During the year, APB also commenced a major project to revise its Statements of Investment Circular Reporting Standards to reflect the EU Prospectus Directive which will be implemented in the UK and Ireland in July 2005. APB issued Exposure Drafts of revisions to its existing SIRs in March 2005 and is developing draft standards in relation to the work of the reporting accountant on prospective financial information and pro forma financial information. Finalisation of the SIRs is a priority for 2005/06.

During the period 2004/05 the APB published a number of Practice Notes and Bulletins containing guidance for auditors. These included a revision of Practice Note 12 on money laundering and new Bulletins providing guidance for auditors on the revised Combined Code on Corporate Governance and on new FSA rules for insurers. During 2005/06 the APB plans to issue guidance to auditors on the first time adoption of IFRS and to update many of its industry-specific Practice Notes to reflect the new requirements of ISAs (UK and Ireland).

There have been three departures from the APB during the year: Sean Murray, Ian Plaistowe and Graham Ward. My thanks to them for their contribution to the work of the Board, and my welcome to Tom Troubridge who joined the Board.

Professional Oversight Board for Accountancy (POBA)

In the first full year of operation of this new operating body, POBA has established its role in the regulation of auditing and in overseeing the accountancy profession.

POBA established the Audit Inspection Unit (AIU) to carry out the monitoring of the quality of the auditing of listed companies and any other entities in whose financial condition there is a major public interest. The creation of this new unit was one of the major decisions of the Government's review of the regulatory regime for the accountancy profession. The AIU visited the four largest audit firms in 2004/05 and will report publicly on the key findings and themes of its visits early in 2005/06.

In its first year, and in advance of assuming its delegated statutory powers, POBA has documented and assessed the regulatory systems and practices by which each of the professional bodies fulfils its role as a recognised supervisory and/or qualifying body.

POBA has undertaken a comprehensive review of the training and education of accountants in the UK, focusing on the way in which this influences the quality of financial reporting. The objective of the review was to support confidence in financial reporting through evaluating the adequacy of the training and education arrangements in the accountancy and audit profession. The professional bodies, accountancy firms, tuition providers, universities and other organisations, as well as trainees, have been closely involved in the review through consultation and workshops. The review focused on a small number of issues that need to be addressed in order to maintain public confidence and the future success of the profession.

POBA has also undertaken a follow-up review of the professional bodies' progress in implementing recommendations from its predecessor body, the Accountancy Foundation. As part of this work, POBA evaluated the need for an ombudsman service and recommended that the accountancy bodies should enhance their alternative disputes resolution mechanisms, including the establishment of an independent arbitration scheme for the resolution of service-related complaints and disputes.

In addition, POBA has published a comprehensive study of the key facts and trends within the accountancy profession, which includes information on the fee income of major audit firms and an analysis of the numbers and size of registered audit firms.

POBA has actively participated in the development of a consistent approach to international regulation of auditors - advising the DTI on the European 8th Directive, sharing best practice with other international bodies as they evolve, and working with the US PCAOB to minimise dual regulation of UK firms registered with the PCAOB.

There were two departures from POBA during the year: Gareth Jones and Sarah Wood. My thanks to them and my welcome to Richard Barfield and David Crowther who joined the Board.

Financial Reporting Review Panel (FRRP)

The FRRP commenced a risk-based approach to the enforcement of accounting requirements in addition to the existing reactive, complaints-driven approach. This new combined approach was one of the main decisions resulting from the Government's review of the regulatory regime for accounting and auditing. It required significant changes to the way in which the FRRP operates and a significant increase in the resources devoted to enforcement.

The FRRP is taking a three stage approach in its risk assessment - selecting industry sectors and specific areas of financial information, combined with an assessment of company specific risk factors. In August 2004, the FRC established a Standing Advisory Group on Pro-activity to assist the FRRP in identifying areas of contemporary risk as part of the process of selecting financial statements for review. (The membership of the Group is shown in Annex B). The FRRP is continuing to develop its proposals with fellow regulators, data providers and others in order to ensure that it delivers a cost effective method of enforcement.

The FRRP reviewed significantly more accounts than it had done in previous years and did not identify any wide-spread material non-compliance. The FRRP will issue a report on the results of its first year of pro-active enforcement of accounting standards in early 2005/06.

The FRRP also worked with other regulators and Government to complete the necessary preparations for the additional responsibilities which the Panel has acquired under the C(AICE) Act 2004. The extension of the FRRP's remit to include the monitoring of the accounting requirements of the Listing Rules, coupled with the need for the UK to demonstrate compliance with the EU Standards on national enforcement arrangements, prompted a thorough review and overhaul of the Memorandum of Understanding with the FSA. The revised MoU reflects a new working relationship between the two authorities in which we co-operate to promote effective monitoring of financial information in the UK and in which we commit to the sharing of relevant information. At the same time, the FRRP developed an MoU with the Inland Revenue which sets out the arrangements through which the Revenue may disclose matters relevant to the FRRP's function.

The FRRP's new responsibilities and powers are reflected in a revised set of operating procedures which, for the first time, were issued in draft for public comment.

During the year, the FRRP contributed to the development of a harmonised approach to the enforcement of accounting requirements across the EU through its role as technical adviser to the FSA on the CESR-Fin Sub-Committee on Enforcement, and as a member of the European Enforcers Coordination Sessions in which all EU national enforcement authorities participate and in which the FRRP is active as an agenda member.

The progress that has been made in 2004/05 will provide the basis for the effective implementation of the FRRP's new responsibilities in 2005/06 and future years.

My welcome to Desmond McCann, Barbara Moorhouse and Richard Murley who joined the Panel during the year.

Accountancy Investigation and Discipline Board (AIDB)

The AIDB deals with cases which raise or appear to raise important issues affecting the public interest in the UK and which need to be investigated to determine whether or not there has been any misconduct by a professional accountant or accountancy firm.

Following a detailed consultation process with the CCAB, the AIDB Scheme and Regulations were agreed and adopted by the AIDB in May 2004. The Scheme was then initially approved by the respective Councils of the ICAEW, ACCA, CIMA and CIPFA. A Case Costs Agreement was also finalised and approved by all parties. Subsequently, ICAS agreed to participate in the AIDB Scheme. Discussions continue with the ICAI about their participation.

The AIDB Scheme has been designed to fulfil the criteria set out in Part 2 of Schedule 11 of the Companies Act 1985 (as amended by Section 1 of the C(AICE) Act 2004) which requires recognised supervisory bodies to participate in appropriate funded arrangements for the independent investigation of public interest cases. The Scheme has also been designed to be fair and to comply with Article 6 of the European Convention on Human Rights as well as the requirements of procedural fairness.

The Scheme operates independently. A majority (at least 60%) of the AIDB's members and its Chairman are non-accountants. A panel of tribunal members (36 in total) to hear disciplinary cases has been selected. The tribunals and appeal tribunals will be composed of a majority of non-accountants. No officers or employees of any of the accountancy bodies, the FRC or any of its operating bodies may be appointed to a tribunal. Panel members have recently completed an induction programme.

The Executive Counsel and Secretary to the Board have been and continue to be active in building links with the DTI and other regulatory and investigation agencies including, in particular, the FSA and SFO, and with the accountancy professional bodies.

Procedures have been established for the acceptance and call-in of cases by the AIDB and for investigations. Recently, a consultation exercise was commenced with the accountancy professional bodies with the aim of establishing guidance for the types of matters which the AIBD will investigate.

The first investigation under the AIDB Scheme is into various matters relating to the Mayflower Corporation Plc. This matter was referred to the AIBD by two of the Participating Institutes (ACCA and ICAEW).

A number of further potential matters for investigation are being monitored on a regular basis.

Committee on Corporate Governance

One of the key new responsibilities given to the FRC was that for corporate governance. Corporate governance continues to be high on the agenda, both in the UK and increasingly in Europe, for Government, companies, investors and the public at large. The Council itself is the decision-making body on the Combined Code on Corporate Governance. The Committee on Corporate Governance, consisting of Council members, helps it fulfill that function.

One of the Committee's main responsibilities is to monitor the operation of the revised Combined Code. The first review will take place during the second half of 2005, by which time all listed companies will have reported against the revised Combined Code for the first time. The Committee was encouraged by the findings of an informal assessment that it carried out in late 2004, which suggested that the corporate governance climate has improved over the last twelve months, with more dialogue between investors and boards, and that issues such as performance evaluation and professional development of directors are being taken seriously. We hope that the formal review will show that further progress has been made.

The Committee will also have an important role in monitoring and influencing EU developments on corporate governance. The FRC attended the EU conference on corporate governance in October 2004 and will keep in close touch with the newly-established EU Corporate Governance Forum and Advisory Group on Corporate Governance and Company Law. We are pleased to report that Colin Perry, a member of the Committee on Corporate Governance, has been appointed to the Advisory Group, which will hold its first meeting in June 2005.

In July 2004 we set up a working party chaired by Douglas Flint (Group Finance Director of HSBC Holdings plc) to review the Turnbull guidance on internal control. The membership of the working party is shown at Annex B. The working party received a significant level of response to its initial consultation, which ended in March 2005, and will reflect this in the further consultation on its proposals early in 2005/06.

Regulation of the actuarial profession

In March 2005, the Morris Review of the Actuarial Profession recommended a key role for the FRC in setting actuarial standards and overseeing the regulation of the profession. This will further develop the FRC's role in promoting confidence in corporate reporting and governance. The FRC will work with HM Treasury, the actuarial profession and other stakeholders, particularly The Pensions Regulator and the FSA, to resolve outstanding issues and establish its new role by the Spring of 2006.

Making the FRC more than the sum of its parts

There are strong connections between standards of corporate reporting and auditing, and their enforcement, and corporate governance and the professionalism of accountants. We believe that the breadth of our responsibilities and functions enhances our effectiveness.

During our first year in our role, we took a number of practical steps to ensure that the FRC increased its effectiveness because of the synergies that have been created through our new responsibilities :

- planning and reporting on our work in a way that will focus activities across the FRC on our five key objectives and reflect our assessment - and our stakeholders' assessment - of the greatest risks to confidence in corporate reporting and governance
- moving to a single site, with a single IT system, making communication easier across the FRC - helping to ensure a consistent, "joined-up" approach to our new responsibilities and making us more easily accessible for those with an interest in our work.

Our experience from the projects and activities which we have undertaken in 2004/05 has confirmed that the bringing together in a single organisation of the functions for which we are now responsible is delivering more effective regulation than would have been possible under the previous arrangements.

Ensuring that we have adequate resources and management processes

Staffing

The significant change in our responsibilities has also resulted in significant organisational change. The average number of staff in 2004/05 was 54 compared to 19 in the previous year. We have had to recruit a significant number of new and suitably qualified staff. At the end of March 2005 we had 57 staff, of whom 35 have been recruited since the expansion of our responsibilities was announced and 8 have joined from the Accountancy Foundation whose functions were transferred to us. We continue to place a high priority on recruiting staff with relevant skills and experience in what is proving to be a more competitive market-place.

Governance

Our arrangements for our governance are evolving to reflect our new responsibilities and higher profile. They will continue to evolve to ensure that we operate within the spirit of the Combined Code and to take account of the additional responsibilities that we will assume for the regulation of the actuarial profession.

Funding

We have put in place a Financial Management and Reporting Framework, set out in our Regulatory Strategy, to provide the framework within which we manage and report on the costs of our activities and how they are reported. A commentary on our expenditure and funding is included in Section Three.

Accountability

We have taken significant steps to ensure that we are accountable for our work, by:

- inviting comments on our Plan & Budget for 2005/06, which we published in December 2004 alongside the Regulatory Strategy
- starting to implement new measures to assess and report on our performance

In Part Four of this report we assess our progress in terms of what we have achieved and also the way we have achieved it. Our assessment reflects a MORI survey of confidence in corporate reporting and governance, conducted in the first quarter of 2005. The results of that survey are in line with the conclusions that we have drawn from our work to monitor and enforce standards. We have concluded that, while there is certainly no room for complacency, our market-led approach can over time contribute to greater confidence in corporate reporting and governance. We will continue to identify priorities for action based on a careful assessment of the greatest risks to confidence.

The FRC will always have to balance the need for regulation against the danger that inappropriate regulation will impose burdens without bringing benefits. We will need to keep a careful eye on the regulatory framework that is now in place to make sure that we maintain that balance. But I am confident that the framework is sufficiently robust, and sufficiently flexible, to achieve the aims that the Government has set.

Conclusion

This was the first year of operation in our new form. Much remains to be done to make the FRC the world class regulator we all want it to be, but significant progress has been made.

I would like to conclude by thanking the members of the Board and the senior management team, the members of the Council, the Chairs and members of the operating bodies and their committees, and those others who have so generously contributed their time to our work. Particular thanks go to all our staff for their part in creating the new FRC and in delivering the results during the year. Everyone's efforts to promote confidence in corporate reporting and governance have helped us to address successfully a series of difficult and often controversial issues while at the same time building our new organisation.

Sir Bryan Nicholson GBE
9 June 2005

Two - Major projects and activities

A summary of our major projects and activities in 2004/05 is set out below. The sequence of material follows the objectives and work streams set out in our Regulatory Strategy (shown in bold).

Objective 1: Promote high quality corporate reporting

a) Contributing to the development and implementation of IFRS

- Worked with the IASB to help develop a international framework for accounting standards that as far as possible:
  - provides a common point of reference for all standard setters - emphasising principles and clarity and promoting consistency in the standards that companies must meet
  - promotes confidence in corporate reporting by contributing to well-informed capital markets (bearing in mind that the UK capital market is the second largest in the world)
  - is appropriate for the largest entities, but does not place disproportionate demands on smaller companies
  - is based on consultation with a wide range of interests and can respond to the continued evolution of accounting thinking and the ways in which businesses operate.
- Contributed to IASB projects to improve and extend international standards:
  - Influenced the IASB to publish in December 2004 an amendment to IAS 19 'Employee Benefits' that makes it more convergent with the equivalent UK standard, FRS 17
  - Continued to lead a research project on accounting for leases and related contractual arrangements
  - Participated in a number of other projects, including that led by New Zealand on 'management commentary', an international term broadly equivalent to the OFR.

b) Influencing EU policy on accounting standards, including the endorsement of IFRS

- Played an active role in EFRAG, which advises the European Commission on the adoption of IFRS and contributes to the work of the IASB. Argued strongly in EFRAG for full EU endorsement of IAS 39 - making progress on the issue of the fair value option carve-out, though the issue of the hedge accounting requirements remains unresolved.

c) Making progress on the convergence of UK accounting standards with IFRS

- Limited the burden of change for companies by continuing a phased approach to the process of bringing remaining UK standards into line with IFRS.
- Issued the following standards to bring corresponding UK standards into line with IFRS and promote consistency between UK and international standards:

  FRS 20 (IFRS 2) 'Share-based Payment'
  FRS 21 (IAS 10) 'Events after the Balance Sheet Date'
  FRS 22 (IAS 33) 'Earnings per Share'
  FRS 23 (IAS 21) 'The Effects of Changes in Foreign Exchange Rates'
  FRS 24 (IAS 29) 'Financial Reporting in Hyperinflationary Economies'
  FRS 25 (IAS 32) 'Financial Instruments: Disclosure and Presentation'
  FRS 26 (IAS 39) 'Financial Instruments: Measurement'

- Published the ASB Technical Plan *www.frc.org.uk/asb/technical/plan.cfm*, seeking views on future priorities.

d) Improving other aspects of UK accounting standards

Accounting for with-profits business by life insurers

- Undertook an urgent study into accounting for with-profits business by life insurers at the request of the then Financial Secretary to the Treasury following the publication of Lord Penrose's 'Report of the Equitable Life Inquiry'.
- Issued FRS 27 'Life Assurance' in December 2004, which improved financial reporting by bringing greater clarity and transparency to the financial statements of entities with life assurance business. In response to consultation, the ASB deferred the implementation date of the standard from December 2004 year ends to December 2005 year ends (and later in the case of a number of the smaller friendly societies). One consequence of the deferral of the standard was that it would not, unless voluntarily adopted, be applied by those entities adopting IFRS from 2005. The ASB agreed to this deferral as a result of the agreement with the major life assurance and bancassurance entities to a proposal for voluntary adoption of the standard within the IFRS framework.
- Continued to discuss with Government, the FSA and the IASB what measures might be needed to effect medium and long-term improvements in insurance accounting, as the basis for a report to HM Treasury.

Accounting for smaller entities

- Contributed to a proportionate approach to accounting requirements for smaller entities by issuing, in November 2004, an Exposure Draft of an amendment to the FRSSE. The amended FRSSE, published on 22 April 2005, applies to accounting periods beginning 1 January 2005.
- Continued to monitor the IASB's project on accounting by Non-Publicly Accountable Entities.

Addressing urgent issues requiring interpretations

- Clarified the interpretation of existing accounting standards by issuing:
  - UITF Abstract 39 'Members' shares in co-operative entities and similar instruments', which has the effect of implementing IFRIC Interpretation 2 in the UK and the Republic of Ireland for entities preparing their financial statements in accordance with UK accounting standards
  - UITF Abstract 40 'Revenue recognition and service contracts', giving guidance on the recognition of revenue (ie turnover) derived from contracts for professional and other services.

Statements of Recommended Practice (SORPs)

- Approved the issue of updated SORPs for local authorities and charities, and agreed to the issue of a draft SORP for Registered Social Landlords.
- Continued work on the interpretation of the ASB's Statement of Principles for Financial Reporting for public benefit entities.

e) Improving communications between companies and investors, including developing and implementing standards for the OFR

- Following consultation with the OFR Advisory Committee, issued an Exposure Draft of the Reporting Standard on the OFR (RED 1) in November 2004. This built on the requirements of the Government's OFR Regulations (then in draft form) and the ASB's existing statement of best practice on the OFR, which was already used by many companies. The Reporting Standard was issued in May 2005.

f) Pro-actively enforcing accounting and other corporate reporting standards

- Commenced a pro-active, risk-based approach to the enforcement of accounting requirements. Established a Standing Advisory Group on Pro-activity and developed a risk-based programme of selection of annual accounts for review.
- On the basis of that programme, have:
  - reviewed 226 sets of annual accounts
  - written to 77 companies requiring additional information
  - set up 12 FRRP Panel Groups to consider particular cases
  - accepted undertakings from 35 companies to improve disclosure in next year's accounts.
- Announced in December 2004 the industry sectors which will be a focus for review in 2005/06, taking account of information provided by the FSA and the Standing Advisory Group.
- Consulted on and revised the FRRP's operating procedures to take account of the provisions of the C(AICE) Act 2004, which provides the statutory powers to underpin our pro-active approach to enforcement, the extension of our remit to include certain reports prepared under the listing rules and our relationship with the Inland Revenue.
- Reviewed and revised the MoU with the FSA to reflect the closer relationship required by the C(AICE) Act 2004.
- Agreed an MoU with the Inland Revenue which set out the arrangements through which the Revenue may disclose matters relevant to the FRRP's functions.

g) Influencing EU policy and practice on the enforcement of accounting standards

- Contributed to the development of an appropriate and consistent approach to the enforcement of accounting requirements across the EU.

Objective 2: Promote high quality auditing

a) Contributing to the development and implementation of International Standards on Auditing (ISAs)

- Worked with the IAASB, with other national standard setters and EU institutions to develop international auditing standards that are understandable, clear and capable of consistent application, thereby serving to enhance the quality of auditor performance and contribute to confidence in corporate reporting.

b) Making progress on the convergence of UK auditing standards with ISAs

- Issued, in December 2004:
  - a suite of ISAs (UK and Ireland) to apply to all audits of financial statements for periods commencing on or after 15 December 2004
  - International Standard on Quality Control (UK and Ireland)
  - Revised Statement 'The Auditing Practices Board - Scope and Authority of Pronouncements'.
- Updated, in conjunction with the IAASB, exposure drafts of the ISAs on materiality and the audit of accounting estimates.

c) Improving other aspects of UK auditing standards and guidance

- Developed guidance:
  - to assist auditors auditing companies applying IFRS for the first time in 2005
  - for auditors of insurance companies and friendly societies in relation to new FSA rules which extend the scope of the auditors' work on regulatory returns
  - on auditors' responsibilities in relation to corporate governance established by the Combined Code
  - on auditors' responsibility relating to corporate governance in local government.
- Finalised changes to SAS 120 and 620 in the light of new anti-money laundering legislation.
- Finalised Practice Notes on money laundering in the UK and the audit of pension schemes.

d) Improving ethical standards for auditors in the UK

- Issued Ethical Standards for Auditors on integrity, objectivity and independence to apply for audits of accounting periods commencing on or after 15 December 2004. In order to ensure that the standards were proportionate in their requirements, they included provisions available for small companies.

e) Independent oversight of the regulation of auditing by the recognised supervisory and qualifying bodies

- Developed recognition processes to consider applications for recognition as a supervisory or qualifying body, which will be published following the formal delegation of powers from the Secretary of State to POBA.
- Developed arrangements to ensure continued compliance with Schedule 11 to the Companies Act 1989 (on the recognition of Supervisory Bodies) through:
  - discussions with the supervisory bodies
  - the development of a programme of cyclical test checks.

- Developed arrangements to ensure continued compliance with Schedule 12 to the Companies Act 1989 (on the recognition of Professional Qualifications) through:
  - discussions with the qualifying bodies
  - the development of a programme of cyclical test checks.
- Developed procedures for the grant of recognition of professional qualifications for audit purposes in the UK.

f) Monitoring the quality of the auditing function in relation to listed companies and any other entities in whose financial condition there is a major public interest

- Established the independent Audit Inspection Unit (AIU) to monitor the audit of those entities whose activities have the greatest potential to affect adversely financial and economic stability.
- Agreed the division of responsibility for work between the AIU and the Quality Assurance Directorate of the ICAEW.
- Developed a work programme for individual audit inspection visits.
- Reviewed the policies, procedures and quality control systems of the UK's four largest audit firms.
- Completed 27 individual audit file reviews for FTSE 100 and FTSE 250 companies and in particular considered the quality of key audit judgements.
- Issued draft reports on the findings from those inspection visits to the individual firms.

g) Contributing to UK Government input on proposed EU legislation and policies on audit; and working with Government to implement them

- Worked closely with the DTI on the negotiations for a new EU 8th Directive on the regulation of auditors, providing expert input and advice.

h) Promoting increased cooperation among international independent audit regulatory authorities

- Promoted a consistent regulatory approach by:
  - developing closer working relationships with the US Public Company Accounting Oversight Board and other overseas regulators.
  - encouraging coordination of the regulation of audit and the oversight of the auditing profession in the EU.

Objective 3: Promote high standards of corporate governance

a) Maintaining an effective Combined Code on Corporate Governance

- Established the Committee on Corporate Governance to keep under review developments in corporate governance, consider whether any actions by the FRC would be desirable, and put proposals to the Council where appropriate.
- Carried out an initial assessment of the implementation of the revised Combined Code, and published our findings in January 2005.
- Promoted the Combined Code by encouraging its effective application and disseminating best practice, for example by working with the Association of Mutual Insurers to develop an annotated version of the Code for the life mutual sector.

b) Ensuring that the guidance on internal control (the Turnbull guidance) is current and relevant

- Issued in December 2004 a consultation document on the Turnbull guidance, seeking views of the effectiveness of the guidance, in what ways it may need to be amended, and what information companies should be asked to disclose to their shareholders.
- Undertook initial research on the awareness and impact of the guidance. The review will be completed later in 2005.

c) Influencing EU and global corporate governance developments

- Issued advice to UK companies in December 2004 on the use of the Turnbull guidance for the purposes of compliance with Section 404(a) of the US Sarbanes-Oxley Act.
- Influenced corporate governance elements of revisions to the 4th, 7th and 8th Company Law directives, and the non-binding Commission recommendation on non-Executive Directors, and commented on proposals for a Directive on shareholders' rights.
- Contributed to the October 2004 EU corporate governance conference.

d) Helping to promote Boardroom professionalism and diversity

- Contributed to the DTI publication, 'Building Better Boards', published in December 2004.

e) Encouraging the interaction between institutional shareholders and company boards

- Encouraged and kept under review market-led initiatives to facilitate dialogue between boards and investors.
- Encouraged greater dialogue through speeches and public announcements.

Objective 4: Promote the integrity, competence and transparency of the accountancy profession

a) Overseeing the way in which the professional bodies exercise their regulatory responsibilities in relation to their members

- Discussed with individual professional bodies their regulatory processes and followed up where necessary progress on specific issues.
- Developed a programme of cyclical test checks on the regulatory activities of the professional bodies.
- Published reports on:
  - Training and Education, which made recommendations for the enhancement of existing training and education arrangements for accountants
  - the professional accountancy bodies' procedures for dealing with complaints and member discipline.
- Published, in February 2005, a new edition of ‘Key Facts and Trends in the Accountancy Profession’.

b) Operating an independent investigation and discipline scheme for matters which raise or appear to raise important issues affecting the public interest

- Finalised and adopted, and kept under review, the AIDB Scheme and Regulations.
- Prepared and kept under review procedures for investigation, case referral and case call-in.
- Established links with other investigating authorities and regulators.
- Established a panel of 36 disciplinary tribunal members.
- Monitored developments and carried out preliminary enquiries relating to potential disciplinary cases.
- Investigated matters relating to Mayflower Corporation plc referred to the AIBD.

c) Establishing standards and guidance for accountants providing assurance services

- Updated the existing SIRs for changes in listing rules arising from the Prospectus Directive, and developed new SIRs on reporting on prospective and pro forma financial information.

Objective 5: Promote our effectiveness as a unified independent regulator

a) Ensuring that we have adequate resources and management processes

- Ensured that membership of the Council and operating bodies was as close as possible to target levels by recruiting appropriately qualified members.
- Recruited additional staff with the necessary skills and experience to enable us to meet our new range of responsibilities.
- Designed and implemented a fit-for-purpose corporate planning process.
- Relocated the FRC from three separate offices into a single site, with an integrated IT system, to facilitate our operation as a unified regulator.
- Quantified and agreed the utilisation of the Accountancy Foundation reserves and began the winding-up of the Accountancy Foundation and its subsidiary companies.

b) Meeting the principles of good regulation and ensuring that we are transparent, accountable and demonstrate our effectiveness

- Part Four of this report contains our assessment of our performance and the extent to which we have followed the principles of good regulation incorporated in our Regulatory Strategy.

c) Developing cooperative arrangements with other regulatory organisations whose activities are relevant to our objectives

- Worked with the DTI, HM Treasury and the FSA to ensure that our activities were coordinated where necessary.
- Worked with the DTI to ensure that the C(AICE) Act 2004, which received Royal Assent in October 2004, provided us with the statutory powers needed to fulfil our remit.
- Maintained, and where necessary developed, good working relationships with EU and other international organisations and organisations in other jurisdictions with similar responsibilities and interests.

d) Ensuring that we are recognised in the UK and internationally as a credible, authoritative and influential organisation

- Worked with the DTI to influence positively the development of corporate reporting and auditing in Europe and internationally.
- Actively managed our key relationships, including those with:
  - the CCAB and other key stakeholders
  - the EU Commission and international regulatory and professional organisations
  - journalists.

Three - Expenditure and funding

Our Financial Management and Reporting Framework, set out in our Regulatory Strategy, provides the framework within which we manage and report on the costs of our activities and how they are funded.

The framework identifies four categories of activity:

- **Core operating costs**, which are both subject to firm budgetary limits and are funded by the tripartite arrangement, under which they are met in equal proportions by the business community, the accountancy profession and the government. Core operating costs include employment costs, accommodation, IT, professional services and other costs.

- **Audit Inspection costs**, which include only the specific and variable costs of the AIU. The fixed overheads of the AIU (principally office accommodation and shared IT systems) are included in core operating costs. The Audit Inspection costs are met by the individual participating bodies with which the firms that are subject to inspection are registered.

- **Investigation and Disciplinary Case costs**, which include only the specific and variable costs of cases taken by the AIDB. The other costs of the AIDB (principally staff, accommodation, shared IT systems and other overheads) are included in core operating costs. The case costs are met by the individual participating bodies to which the members or firms that are the subject of each case belong. The total of these costs will depend on the number and complexity of cases and cannot be subject to firm budgetary limits. In the event of disciplinary complaints being brought, the disciplinary tribunals have powers to award costs against those found guilty of misconduct.

- **Review Panel Case costs**, which include only the specific and variable costs of cases which the FRRP decides or prepares to take to court. These costs are met in the first instance from the Review Panel Case costs fund (currently £2m), which is then replenished in the following financial year under the tri-partite funding arrangement. The other costs of the FRRP (principally the Director and other staff, office accommodation and shared IT systems) are included in core operating costs.

We published our proposed budget for 2004/05 in November 2003. At that point we expected that our core operating costs for 2004/05 would be in the order of £10.3m. At the start of 2004/05 we re-assessed our expenditure plans and concluded that as a result of a phased implementation of our new responsibilities we could operate to a lower financial target (our “Operating Plan”) of £9.3m.

Summary of expenditure

Our actual expenditure, analysed into the four categories of activity in our Financial Management and Reporting Framework, is set out below. The change in the scope of our activities from 1 April 2004 was so significant that comparisons with 2003/04 are not considered meaningful.

	Actual 2004/05 £m	**Operating Plan 2004/05 £m**
Core operating costs	8.8	9.3
Audit Inspection costs	1.0	1.1
Investigation & Disciplinary case costs	0.3	-
Review Panel Case costs	-	-
Total	10.1	10.4

The Framework is consistent with the way in which we manage our costs and the basis on which they are funded. Our audited financial statements are in Annex A on pages 42 to 54. The expenditure as reported above can be reconciled to the audited financial statements as follows:

	£m
Total expenditure in the table above	10.1
Add exceptional charge for onerous lease	2.2
	12.3
Deduct capital expenditure included in core operating costs	(1.2)
Net operational expenditure per audited financial statements	11.1

Core operating costs

Core operating costs, analysed by category of expenditure, were as follows:

	Actual 2004/05 £m	**Operating Plan 2004/05 £m**
Staff costs	5.0	5.5
Accommodation costs	1.2	1.1
Professional fees	0.7	0.5
IT costs	0.2	0.1
Other costs	0.9	0.9
Contingency	0.0	0.1
	8.0	8.2
Sundry income (net)	(0.4)	(0.2)
Capital expenditure	1.2	1.3
	8.8	9.3
Staff numbers (excluding AIU)	46	51

Staff costs were below the operating plan as a result of deferring recruitment during the year. Accommodation costs were higher because we incurred occupancy costs on our new offices earlier than planned. The total cost of securing the lease and fitting out our new offices was in line with our plan, although the amount of capital expenditure was a little lower and professional fees a little higher. Sundry income was higher due to higher than expected interest earning cash balances and higher than expected publications income.

Core operating costs, analysed by operating unit, were as follows:

	Actual 2004/05		Operating Plan 2004/05	
	£m	Staff	£m	Staff
ASB	2.8	16	2.9	16
APB	1.2	7	1.3	7
FRRP	1.2	6	1.3	8
POBA	1.1	5	1.2	6
AIDB	0.7	3	0.8	4
CGU	0.1	1	0.1	1
Corporate	0.7	4	0.7	4
Support Services	1.0	4	1.0	5
Total	8.8	46	9.3	51

The above figures have been calculated on a consistent basis: the core operating costs of each operating unit plus an allocation of the central costs such as rent, rates and service charges. The allocation is based on the number of full time staff in each operating unit.

Audit inspection costs

The cost of the AIU was £1.0m, which was the cost of meeting the programme of independent audit inspections discussed under Objective 2 (f). The average number of AIU staff during the year was 8.

Investigation and disciplinary costs

During the year, the AIDB incurred case costs of £0.3m in relation to the Mayflower investigation.

The levy on listed companies for 2004/05

The levy on listed companies is collected on behalf of the FRC by the FSA at the same time that it collects its own fees.

For 2004/05, we set a higher levy rate for companies in the FTSE 350 (£4,250) than for other listed companies (£1,600) because they have a greater potential impact on our aim of promoting confidence in corporate reporting and governance. In 2004/05 the amount collected in respect of core operating costs was £9.2m.

In March 2005 we published proposals to change the basis of the levy from flat fees to a fee related to market capitalisation with effect from 1 April 2005 and to review the possibility of expanding the range of public companies that contribute to our costs. We will announce the details of the levy for 2005/06 in June 2005.

Reserves

In our Regulatory Strategy we explained that the Directors believe that it is prudent to maintain reserves to meet unforeseen circumstances and that the Directors would keep the level of reserves under review. In previous years the reserves were about £0.5m.

At 31 March 2005 the FRC's General Fund was in deficit by around £0.3m compared to a surplus of £0.4m at 31 March 2004. The main reason for this deterioration in the level of reserves was the exceptional charge of £2.2m for the onerous lease of the former premises of the Accountancy Foundation, of which only £1.1m had been recovered from sponsors by 31 March 2005. The balance of unrecovered costs is planned to be recovered from sponsors during the period until the tenant's break-point in the lease.

Excluding the unrecovered lease costs, the general reserves were around £0.8m. The increase of £0.4m during the year is due to the under-spend on core operating costs. Given the significant expansion of the FRC's responsibilities and the increase in its operating cost base the Directors have concluded that it would be appropriate to add the under-spend to reserves rather than return it to sponsors by way of a reduction in the levy for 2005/06. The Directors will continue to keep the level of reserves under review.

Four - Performance assessment

We have assessed three aspects of our performance (Outcomes, Outputs and Effectiveness) within the framework established in our Regulatory Strategy:

1. Outcomes

Our assessment of the outcomes of our work is based on:

- the evidence obtained during our monitoring and enforcement activities
- a survey of the confidence of company directors and investors in corporate reporting, auditing and corporate governance - conducted on our behalf by MORI in the first quarter of 2005

a) Corporate reporting

During 2004/05, the FRRP began to select accounts for review on the basis of risk assessment, supplemented by complaints and referrals. Reviews and subsequent enquiries by the FRRP did not indicate any wide-spread material non-compliance. But in a number of cases they did reveal non-compliance with more detailed accounting requirements, which is disappointing. Companies responded positively to the FRRP's comments and undertook to take account of them in future reporting.

Our survey evidence showed the following level of confidence in corporate reporting, and the degree to which this had increased or stayed the same over the last four years:

	Current perception		**Change since 2001**	
	Very confident	Fairly confident	Increased	Stayed the same
Company Directors	32%	63%	69%	24%
Investors	22%	76%	62%	28%

b) Auditing

In the first year of operation the AIU focused on the Big 4 audit firms and a sample of their FTSE 100 and 250 audits. The AIU's monitoring approach is intended to be challenging, focusing on judgments in addition to audit processes. The AIU found that the key audit judgments appeared, in the great majority of cases, to be appropriate and soundly based. However, the basis for such judgments was often not adequately documented. As regards the policies, procedures and systems of quality control the AIU found no systemic weaknesses but identified areas where improvements could be made. The AIU has made recommendations to the Big 4 audit firms and has issued a comprehensive Public Report.

Our survey evidence showed the following level of confidence in auditing, and the degree to which this had increased or stayed the same over the last four years:

	Current perception		**Change since 2001**	
	Very confident	Fairly confident	Increased	Stayed the same
Company Directors	37%	50%	46%	42%
Investors	20%	70%	40%	32%

c) Corporate governance

Between September and November 2004, we held discussions on the Combined Code on Corporate Governance with business and investors and analysed annual reports and publicly available survey data. We found that:

- investors and companies alike considered that the corporate governance climate had improved over the last twelve months
- investors reported an increased dialogue with companies and greater chair involvement on corporate governance issues during that period
- some companies had already reported in their 2004 annual reports, a year in advance of the need for compliance, how they stand in relation to the revised Combined Code

- companies may need time to implement some provisions, for example where they need to rebalance board membership to meet the provision that at least 50% of the board should be independent non-executive directors
- other issues leading to greater professionalism, such as performance evaluation and professional development, are being taken seriously, with significant debate about the best approaches.

Our survey evidence showed the following level of confidence in corporate governance, and the degree to which this had increased or stayed the same over the last four years:

	Current perception		**Change since 2001**	
	Very confident	Fairly confident	Increased	Stayed the same
Company Directors	24%	68%	71%	25%
Investors	12%	82%	74%	12%

d) The integrity, competence and transparency of the accountancy profession

On the basis of its work in 2004/05, POBA has concluded that:

- The recognised supervisory and recognised qualifying bodies have well-developed systems for meeting the requirements for recognition, and devote considerable time and resource to these systems.
- On complaints and discipline systems, an ombudsman scheme was not called for and would be disproportionate. However, the accountancy bodies should enhance their alternative disputes resolution mechanisms, including the establishment of an independent arbitration scheme for the resolution of service-related complaints and disputes. Should the bodies consider this cost-effective, a single independent arbitration scheme should be set up across the bodies to offer an alternative to court proceedings where both parties are willing to participate.

- On training and education, the current arrangements were generally successful. They help attract many bright graduates and other talented people to the profession and through a combination of theoretical and practical training produce many highly competent individuals who are able to progress to senior positions in business and the public sector. The professional accountancy bodies are also working to develop the commitment to career-long learning within their membership. Whilst noting the positive aspects of the existing arrangements, there is a need to ensure that new accountants develop a strong understanding of the relevance and importance of the work of the accountancy profession to the effective working of the capital markets and to the wider public interest. Such understanding is an essential foundation for a meaningful commitment to the profession's values and codes of conduct, including career-long learning. Recommendations were made to help ensure that this understanding is achieved.

2. Outputs

Our outputs fall into two broad categories, each of which we aim to undertake in an appropriate and timely way:

(a) Projects

(b) Monitoring and enforcement activities

Section Two of this report demonstrates that we have completed a large number of projects and activities to take forward each of the five key objectives set out in our Regulatory Strategy.

3. Our effectiveness as an independent regulator

We have assessed three aspects of our effectiveness:

(a) Our adherence to our Regulatory Philosophy

We have demonstrated our commitment to each aspect of our regulatory philosophy:

Working on the basis that a well-informed market is the best regulator

- We have consulted publicly and with our stakeholders to ensure that as far as possible our work addresses the main risks to confidence in corporate reporting and governance and does not impose an inappropriate or disproportionate burden on market participants.

Targeting the use of our powers

- We have established the Standing Advisory Group on Pro-activity to advise on industry sectors in selecting accounts for review.
- In July 2004 the DTI published RIAs for the main elements of the C(AICE) Act 2004 - including the provisions establishing the FRC's new powers in relation to the regulation and review of audit and the enforcement of accounting requirements. For 2005/06 we are putting in place arrangements to ensure that significant FRC proposals are covered by RIAs.

Emphasising principles and clarity in our standard-setting and rule-making

- The accounting, auditing and reporting standards issued during 2004/05 were in general principles-based.

Being consultative

- The FRC consulted in an effective and timely way on significant proposals during the year - using advisory groups where appropriate (for example on the review of insurance accounting and the development of a reporting standard for the OFR).
- We make available on our website information on current proposals and the details of consultation arrangements.

Actively helping to shape EU and global approaches to accounting, auditing and corporate governance

- We have used our influence in the EU and internationally:
  - to promote a principles-based approach to standard-setting and avoid unnecessarily detailed prescription
  - to encourage international convergence and co-operation between regulatory authorities.

Being transparent, accountable and efficient in our work, and ensuring that it receives appropriate publicity

- See section (b) and (c).

(b) Our accountability

We have:

- published and invited comments on our Plan & Budget for 2005/06.
- published up to date information about our work.

(c) Managing our finances effectively

Part Three of this report shows that our core operating costs were less than planned.

Our Annual Report and Financial Statements have received an unqualified audit opinion.

Annex A - Directors' Report and Accounts for the year ended 31 March 2005

Contents

Directors' Report

The Directors have pleasure in presenting their report and financial statements for the year ended 31 March 2005.

Board of Directors

All FRC directors are appointed by the Secretary of State, Trade and Industry.

*Sir Bryan Nicholson GBE	Chair (appointed 1 July 2001)
*† The Hon Barbara Thomas Judge	Deputy Chair (appointed 1 March 2004)
*†Tim Breedon	Deputy Chief Executive, Legal and General (appointed 16 August 2004)
*†Paul Druckman FCA	President, ICAEW (appointed1 July 2004)
*†Sir John Egan	President of the CBI (resigned 31 May 2004)
*†David Illingworth	President ICAEW (resigned 30 June 2004)
*†John Sunderland	President of the CBI and Chairman, Cadbury Schweppes (appointed 1 June 2004)

The directors of FRC Limited, who are also members of the Nominations and Remuneration Committees are indicated by * and the Audit Committee are indicated by †.

Sir John Egan was until 31 May 2004 President of the CBI and was succeeded by John Sunderland the new President of the CBI. David Illingworth was until 30 June 2004 Chairman of the CCAB and was succeeded by Paul Druckman the new Chairman of the CCAB. The third director, Tim Breedon, was drawn from the investor community.

Under the terms of the FRC's Memorandum and 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.

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:

Sir Bryan Nicholson	4/4
The Hon Barbara Thomas Judge	4/4
Tim Breedon	2/3
Paul Druckman	2/3
David Illingworth	1/1
John Sunderland	4/4

There were no meetings during the part of the year in which Sir John Egan was a Director.

Principal Activities

The principal activity of the FRC and its operating bodies is the promotion of confidence in corporate reporting and governance. Its operating bodies are the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Financial Reporting Review Panel (FRRP), the Professional Oversight Board for Accountancy (POBA) and the Accountancy Investigation and Discipline Board Limited (AIDB).

Review of the business and future developments

The activities of the FRC during 2004/05 are described on pages 1 to 32. In 2005/06 the major development in the FRC's activities is expected to be the preparations to extend the scope of our regulatory activities to the actuarial profession.

Committees of the Board

Nomination Committee

The Nomination Committee consists of the directors of the FRC and is chaired by Sir Bryan Nicholson. It is responsible for the selection process and succession planning for members and observers of the Council and members of the operating bodies. The Committee is also responsible for the oversight of the selection process of the Company senior management. During the year, the Committee approved forty one appointments and re-appointments to the Council and operating bodies and one senior management appointment.

Remuneration Committee

The Remuneration Committee consists of the directors of the FRC and is chaired by John Sunderland. It is directly responsible for determining and reviewing the remuneration policy for the FRC. It sets the remuneration of the Chief Executive, the remuneration for Chairs and members of the operating bodies, and approves the remuneration recommendations of the Chief Executive for the senior management. The Committee has met once and all members attended.

Audit Committee

The Audit Committee consists of the directors of the FRC, other than the FRC Chairman, and is chaired by Paul Druckman. It is responsible for monitoring the quality and integrity of the accounting, auditing, and reporting practices of FRC Ltd and its subsidiaries. The Committee's purpose is to scrutinize the accounting and financial reporting processes of the Group and Company and the audits of the Group and Company's financial statements. It reviews the qualifications and the performance of the public accounting firm engaged as the independent auditors in the preparation and issue of the audit report on the financial statements. The Committee considers the appointment, compensation, retention and oversight of the independent auditor, making recommendations to the Board on these matters.

The Committee has met once to consider the 2004/05 Annual Accounts and all members attended less Barbara Thomas Judge.

The FRC is a small organisation with few staff having a role in the financial reporting processes. The Committee has reviewed the need for an internal audit function and concluded that it is neither necessary nor cost effective for the FRC.

The independent auditor has in the year provided some non audit services for the FRC. Objectivity and independence has been safeguarded through robust process to avoid conflicts of interest and requiring the partners and staff of the auditors to declare their independence on an annual basis. The Committee are agreed that the objectivity of the audit engagement partners and audit staff are not impaired.

A resolution for the reappointment of Horwath Clark Whitehill LLP as auditors to the Company will be put to the Annual General Meeting.

FRC Council

The Council has up to 30 members (including the 5 directors of FRC Ltd, the chairs of the operating bodies, and the Chief Executive), and in addition a number of observers from other bodies with an interest in our work. It has wide and balanced representation from the business, investor, professional and other communities with an interest in corporate reporting and governance.

Financial Review

From 1 April 2004, the FRC assumed the activities of the Accountancy Foundation. The Company incorporated three new subsidiaries, through which the AIDB, the APB and the POBA operate.

Total operational expenditure was £11,711,000 (2003/04 £4,441,000). As reported in the Financial Statements, the Company has made an exceptional provision of £2,192,000 in respect of the obligations attaching to the leasehold property formerly occupied by the Accountancy Foundation. This property is no longer occupied by the Company and accordingly full provision has been made for the present value of future net obligations. The current annual commitment relating to this leasehold property is

£421,000. The lease extends to December 2015 with a break clause in September 2010. The directors, however, expect that the Company will continue to receive funding adequate to meet its future operational commitments and, on this basis, consider it appropriate to prepare the accounts on a going concern basis.

No investigation costs were charged to the Legal Costs Fund during the year (2003/04 £8,000). The Legal Costs Fund may be used only to meet legal, professional and other costs of the FRRP's investigations.

Income from publications was £439,000 (2003/04 £404,000). Interest, including interest on the Legal Costs Fund which from 1 April 1993 has been used to offset general operating costs, amounted to £195,000 before taxation (2003/04 £90,000).

The Company obtained funding for the year from the following organisations:

- Department of Trade and Industry
- Consultative Committee of Accountancy Bodies
- Listed companies

Contributions from sponsors under the tri-partite funding arrangement for operating costs and capital expenditure amounted to £9,231,000 (2003/04 £2,495,000). Of this income £1,217,000, relating to capital expenditure, has been deferred in accordance with SSAP 4 (Accounting for government grants) (2003/04 nil). £94,000 of the deferred income has been released in year. In addition we have received an exceptional contribution of £1,000,000 from the DTI towards the costs of the onerous lease.

The contributions received during the year from sponsors earmarked for the fund equalled costs actually incurred in 2003/04 restoring the fund to its target level of £2,000,000. As is indicated in Note 8 to the accounts, sponsors' contributions to make good drawings on the Legal Costs Fund are not sought until the financial year following the drawings.

The Audit Inspection and Investigation and Discipline case costs were funded entirely by the relevant CCAB bodies.

There was deficit for the year on general activities of £736,000 (2003/04 £74,000 deficit). The accumulated deficit at 31 March 2005 was £310,000 (2003/04 £426,000 surplus).

Directors' Emoluments

The directors' remuneration is determined and reviewed by the Secretary of State, Trade and Industry. Remuneration received was:

	2004/05	2003/04
	£	£
Sir Bryan Nicholson GBE	100,000	35,000
The Hon Barbara Thomas Judge	20,000	-
Tim Breedon	9,442	-
Paul Druckman	11,250	-
Sir John Egan	1,666	10,000
John Sunderland	12,500	-

The Directors do not receive any additional benefits.

BY ORDER OF THE BOARD

Michael Lewington
Secretary
9 June 2005

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the surplus or deficit of income over expenditure of the Group for that period. In preparing those financial statements the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to assume that the Group will continue in business.

The directors are responsible for keeping proper accounting records which 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 1985. They are also responsible for safeguarding the assets of the Company and hence taking reasonable steps for the prevention and detection of fraud or other irregularities.

Independent Auditors' Report to the Members of the Financial Reporting Council Limited

We have audited the financial statements of The Financial Reporting Council Limited which are set out on pages 42 to 54. These financial statements have been prepared under the historical cost convention and the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 opinion we have formed

Respective responsibilities of Directors and Auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's statement, the Directors' Report and the reports on major projects and activities, expenditure and funding and performance assessment. It also comprises the annexes relating to the membership of Council and operating bodies, organisation and staff, abbreviations, additional material on the FRC website and contact details. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of the Financial Reporting Council report and financial statements, whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of the information in the financial statements.

Unqualified opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Group and Company as at 31 March 2005 and of the Group's deficit of income compared to expenditure for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

LONDON
9 June 2005

HORWATH CLARK WHITEHILL LLP
Chartered Accountants and Registered Auditors

The Financial Reporting Council Limited
Consolidated income and expenditure account
Year ended 31 March 2005

	Notes	**2004/05** £'000	*2003/04 (re-stated: note 1b)* £'000
OPERATIONAL EXPENDITURE			
Staff Costs	2	**5,482**	*2,043*
Other operating charges	4	**3,710**	*991*
Exceptional charge for onerous lease	5	**2,192**	-
AIDB case costs		**327**	-
Exceptional charge for implementation costs	6	**-**	*1,399*
FRRP case costs		**-**	*8*
TOTAL OPERATIONAL EXPENDITURE		**11,711**	*4,441*
LESS: SUNDRY INCOME			
Income from publications		**(439)**	*(404)*
Interest receivable	7	**(195)**	*(90)*
NET OPERATIONAL EXPENDITURE		**11,077**	*3,947*
CONTRIBUTIONS FROM SPONSORS FOR			
Core operating costs	9	**8,045**	*2,485*
Cost of onerous lease	5	**1,062**	-
AIU costs		**957**	-
AIDB case costs		**327**	-
FRRP case costs		**8**	*10*
Implementation costs	6	**-**	*1,399*
TOTAL CONTRIBUTIONS FROM SPONSORS		**10,399**	*3,894*
(DEFICIT)/SURPLUS ON ORDINARY ACTIVITIES BEFORE TAXATION			
General Fund		**(686)**	*(55)*
FRRP Legal Costs Fund	8	**8**	*2*
		(678)	*(53)*
TAXATION	10	**(50)**	*(19)*
(DEFICIT)/SURPLUS OF INCOME OVER EXPENDITURE FOR THE FINANCIAL YEAR			
General	11	**(736)**	*(74)*
FRRP Legal Costs Fund	8	**8**	*2*
	11	**(728)**	*(72)*

The notes on pages 45 to 54 form part of these financial statements. There were no recognised gains or losses in the current or previous financial period other than those contained within the Consolidated Income and Expenditure account, and accordingly a Statement of Total Recognised Gains and Losses has not been presented.

The Financial Reporting Council Limited
Balance Sheets
31 March 2005

Group		**Company**			
		2005	*2004*	**2005**	*2004*
	Notes	**£'000**	*£'000*	**£'000**	£'000
FIXED ASSETS					
Tangible assets	12	**1,235**	*32*	**1,235**	*32*
CURRENT ASSETS					
Debtors	13	**497**	*309*	**510**	*309*
Cash at bank and in hand:					
General	14	**2,946**	*733*	**2,946**	*733*
Legal Costs Fund	14	**2,036**	*2,004*	**-**	-
		4,982	*2,737*	**2,946**	*733*
		5,479	*3,046*	**3,456**	*1,042*
CREDITORS:					
Amounts falling due within one year	15	**(1,741)**	*(660)*	**(1,718)**	*(648)*
NET CURRENT ASSETS		**3,738**	*2,386*	**1,738**	*394*
TOTAL ASSETS LESS CURRENT LIABILITIES		**4,973**	*2,418*	**2,973**	*426*
CREDITORS:					
Amounts falling due after more than one year	16	**(1,005)**	-	**(1,005)**	-
PROVISIONS FOR LIABILITIES AND CHARGES	17	**(2,278)**	-	**(2,278)**	-
NET ASSETS		**1,690**	*2,418*	**(310)**	*426*
CAPITAL AND RESERVES					
Accumulated (deficit)/surplus	11	**(310)**	*426*	**(310)**	*426*
FRRP Legal Costs Fund	8 & 11	**2,000**	*1,992*	**-**	-
		1,690	*2,418*	**(310)**	*426*

Approved by the Board of Directors on 9 June 2005 and signed on its behalf by:
Sir Bryan Nicholson GBE, Chairman
Paul Boyle, Chief Executive

The notes on pages 45 to 54 form part of these financial statements.

The Financial Reporting Council Limited
Consolidated cash flow statement
Year ended 31 March 2005

	Notes	2004/05	2003/04
		£'000	*£'000*
NET CASH INFLOW FROM OPERATING ACTIVITIES	18	**2,066**	*283*
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		**195**	*90*
TAXATION			
Corporation Tax paid		**(17)**	*(17)*
CAPITAL EXPENDITURE			
Cash paid for fixed assets		**(1,217)**	*(5)*
Contributions from sponsors towards capital expenditure		**1,217**	*5*
Proceeds from disposal of fixed assets		**1**	-
		1	-
NET CASH INFLOW BEFORE AND AFTER FINANCING		**2,245**	*356*
INCREASE IN CASH IN THE YEAR	14	**2,245**	*356*

RECONCILIATION OF MOVEMENT IN NET FUNDS

	2004/05	2003/04
Net funds at 1 April 2004	**2,737**	*2,381*
Increase in cash in the year	**2,245**	*356*
Net funds at 31 March 2005	**4,982**	*2,737*

Net funds consist solely of cash at bank.

The notes on pages 45 to 54 form part of these financial statements.

1. Notes to the Financial Statements

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

a) Basis of Preparation

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards. There is an accumulated deficit on the General Fund as at 31 March 2005. This is due primarily to the exceptional charge in respect of the onerous lease obligations attaching to the property formerly occupied by the Accountancy Foundation, whose activities were assumed by the Financial Reporting Council as from 1 April 2004 (see note 5). The directors, however, expect that the company will continue to receive funding adequate to meet its future commitments as they fall due and, on this basis, consider it appropriate to prepare the financial statements on a going concern basis.

b) Accounts presentation

In order to reflect more fairly that the group's expenditure is met by contributions from sponsors, the directors have amended the presentation of the Income & Expenditure Account to focus initially on the group's net operational expenditure and funding requirement and thereafter on the various contributions received from its sponsors. Further categories have been included to provide a better and fairer picture of the accounts. The presentation of the figures in respect of the previous year have been amended accordingly. There has been no effect on the reported deficit for that year.

c) Basis of Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries, after elimination of balances and transactions between members of the Group

d) Contributions from Sponsors

Contributions from sponsors towards general operational expenditure, FRRP legal costs (note 8), AIDB case costs and AIU costs are credited to the Income and Expenditure account when they become receivable.

Contributions from sponsors towards capital projects are included as deferred income and are credited to the Income and Expenditure Account over the expected useful life of the relevant tangible fixed assets on a basis consistent with the depreciation policy applied in respect of those assets.

e) Case Costs

The legal and professional costs of AIDB and FRRP cases cannot be estimated with reasonable certainty until the investigation is substantially complete. Provision is made to the extent that costs have been incurred at the balance sheet date. Legal and professional investigation costs of FRRP cases are charged to the Legal Costs Fund.

f) Depreciation

Depreciation is provided on all tangible fixed assets 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	5 years	straight line basis
Leasehold improvements	over term of lease	straight line basis

g) Leased Assets

Total rentals payable under operating leases are charged to the Income and Expenditure account over the term of the lease on a straight line basis.

h) Dilapidations

Provision is made for the estimated costs of dilapidation repairs spread over the period of the company's tenancy of its leasehold property. Estimated costs of removing leasehold improvements are provided and capitalised in accordance with FRS15, such expenditure being amortised over the term of the lease.

i) Deferred Taxation

The Group is only subject to Corporation Tax on its interest receivable and analogous income. There is no timing difference between the recognition of that income in the financial statements and the tax computation, and no timing differences arise. Accordingly, there is no provision for deferred tax.

2. STAFF COSTS (INCLUDING DIRECTORS)	**2004/05**	*2003/04*
	£'000	*£'000*
Permanent staff:		
Salaries	**3,805**	*1,286*
Social security costs	**451**	*158*
Other pension costs	**242**	*94*
	4,498	*1,538*
Seconded staff (inclusive of all related employment costs)	**389**	*225*
Fees to operating body and committee members	**499**	*201*
Other costs	**99**	*79*
	5,482	*2,043*

The Group does not operate a pension scheme. Other pension costs comprise payments to personal pension schemes.

The average monthly number of employees during the year was as follows:

	2004/05	*2003/04*
	No.	*No.*
ASB	**16**	*9*
AIU	**8**	-
APB	**7**	-
FRRP	**6**	*2*
POBA	**5**	-
AIDB	**3**	-
Support Services and Corporate	**9**	*8*
	54	*19*

3. DIRECTORS' EMOLUMENTS

	2004/05	*2003/04*
	£'000	*£'000*
Fees (included in staff costs)	**155**	*45*

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

4. OTHER OPERATING CHARGES

	2004/05	*2003/04*
	£'000	*£'000*
Other operating charges include:		
Depreciation (note 12)	**115**	16
Auditors' remuneration		
- group audit fees	**15**	*7*
- other services	**9**	*7*
Operating leases (note 1g)		
- office equipment	**32**	*14*
- land and buildings	**796**	*160*
Loss on disposal of fixed assets	**8**	-

The amount charged to the parent company in respect of audit fees was £4,000 (2003/2004: £4,000). The amount of auditors' remuneration is stated inclusive of the irrecoverable element of Value Added Tax charged.

5. CHARGE FOR ONEROUS LEASE AND RELATED INCOME

The company has assumed the obligations attaching to the leasehold property formerly occupied by the Accountancy Foundation, whose activities were transferred to the company as from 1 April 2004. This property is no longer occupied by the company and accordingly full provision has been made for the present value of future net obligations. The Department of Trade and Industry made an exceptional contribution of £1,000,000 in respect of these obligations which may not be used to meet other costs incurred by the Group. The balance of the costs of the onerous lease is intended to be recovered from sponsors over the period until the tenant's break-point in the lease. £62,000 of the balance was recovered in the year ended 31 March 2005.

6. IMPLEMENTATION COSTS AND RELATED INCOME

During the year ended 31 March 2004, the Company incurred expenditure to implement the Government's decision that the Financial Reporting Council should take responsibility for auditing standards, their enforcement and oversight of the regulatory activities of the accountancy professional bodies. The total costs incurred by the Company were £1,399,000 which were met by the Department of Trade and Industry by way of contributions over and above its normal sponsorship.

7. INTEREST RECEIVABLE

From 1 April 1993 interest, including interest on the Legal Costs Fund has been used to offset general operating costs.

	2004	*2003*
	£'000	*£'000*
Bank interest - general	104	17
Bank interest - Legal Costs Fund (note 8)	91	73
	195	90

8. FRRP LEGAL COSTS FUND

Contributions have been received to enable The Financial Reporting Review Panel Limited to take steps to ensure compliance with the accounting requirements of the Companies Act 1985, including applicable accounting 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 Group. The Financial Reporting Review Panel Limited 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 Trade and Industry for the purposes of section 245B of the Companies Act 1985.

Since the costs of Review Panel investigations in a financial year cannot be forecast with sufficient certainty, sponsors' contributions to make good drawings on the Legal Costs Fund are not sought until the financial year following the drawings.

	2004/05	*2003/04*
	£'000	*£'000*
The Fund is represented by:		
Cash at bank and in hand	**2,036**	*2,004*
Amounts due (to)/from parent company	**(13)**	*2*
Taxation payable	**(23)**	*(14)*
	2,000	*1,992*
The movements in the Fund during the year were as follows:		
Contributions from sponsors	**8**	*10*
Costs of Review Panel investigations	**-**	*(8)*
	8	*2*

9. CONTRIBUTIONS FROM SPONSORS - CORE OPERATING COSTS

Contributions from sponsors towards core operating costs include £94,000 (2004: nil) of deferred income released in accordance with note 1(d).

10. TAXATION

	2004/05	*2003/04*
	£'000	*£'000*
Corporation Tax at 26% (2003/2004:19%) on general interest received	**27**	*3*
Corporation Tax at 25% (2003/2004:19%) on interest received by the Legal Costs Fund (note 8)	**23**	*14*
Adjustment in respect of previous year	**-**	2
	50	*19*

Tax is payable only on interest and analogous income.

11. (DEFICIT)/SURPLUS OF INCOME OVER EXPENDITURE FOR THE FINANCIAL YEAR

The Company has taken advantage of the exemption conferred by section 230 of the Companies Act 1985 not to present its own individual income and expenditure account in these financial statements. The Company's deficit for the year was £736,000 (2003/04: £74,000). Changes in the Company and Group's capital and reserves were as follows:

	Company & Group	**Group**	**Group**
	General Fund	FRRP Legal Costs Fund	Total
	£'000	£'000	£'000
At 31 March 2003	**500**	**1,990**	**2,490**
(Deficit)/Surplus for 2003/04	**(74)**	**2**	**(72)**
At 31 March 2004	**426**	**1,992**	**2,418**
(Deficit)/Surplus for 2004/05	**(736)**	**8**	**(728)**
At 31 March 2005	**(310)**	**2,000**	**1,690**

Contributions from Government in 2004/05 were £4,083,000, including a £1,000,000 contribution towards onerous lease costs referred to in note 5 (2003/04: £2,234,000, including sums received £1,399,000 in respect of implementation costs referred to in note 6).

12. TANGIBLE ASSETS

	Group and Company			
	Leasehold Improvements	Office Equipment	Fixtures, Fittings & Furniture	Total
	£'000	£'000	£'000	£'000
Cost at 1 April 2004	**-**	**75**	**210**	**285**
Additions	**655**	**325**	**347**	**1,327**
Disposals	**-**	**(29)**	**(211)**	**(240)**
Cost at 31 March 2005	**655**	**371**	**285**	**1,372**
Depreciation at 1 April 2004	**-**	**51**	**202**	**253**
Charge for year	**42**	**48**	**25**	**115**
Disposals	**-**	**(27)**	**(204)**	**(231)**
Depreciation at 31 March 2005	**42**	**72**	**23**	**137**
Net book value at 31 March 2005	**613**	**299**	**323**	**1,235**
Net Book Value at 31 March 2004	*-*	*24*	*8*	*32*

13. DEBTORS: amounts falling due within one year

	Group		Company	
	2005	*2004*	**2005**	*2004*
	£'000	*£'000*	**£'000**	*£'000*
Amount due from subsidiary undertaking	**-**	-	**155**	*15*
Other debtors	**314**	*180*	**286**	*165*
Prepayments and accrued income	**183**	*129*	**69**	*129*
	497	*309*	**510**	*309*

14. CASH AT BANK AND IN HAND

	Company & Group	Group	Group
	General accounts	FRRP Legal Costs Fund accounts	Total
	£'000	£'000	£'000
At 31 March 2003	**379**	**2,002**	**2,381**
Net cash inflow in 2003/04	**354**	**2**	**356**
At 31 March 2004	**733**	**2,004**	**2,737**
Net cash inflow for 2004/05	**2,213**	**32**	**2,245**
At 31 March 2005	**2,946**	**2,036**	**4,982**

The unutilised portion of the exceptional contribution from the DTI (£965,000) and the amount in the FRRP Legal Costs Fund accounts may be used only for the purposes described in notes 5 and 8 respectively.

15. CREDITORS: amounts falling due within one year

	Group		Company	
	2005	*2004*	**2005**	*2004*
	£'000	*£'000*	**£'000**	*£'000*
Trade creditors	**347**	*92*	**347**	*92*
Corporation Tax payable	**50**	*17*	**27**	*3*
Due to subsidiary company	-	-	**447**	*2*
Accruals	**631**	*443*	**631**	*443*
Deferred income	**231**	-	**231**	-
Other creditors	**482**	*108*	**35**	*108*
	1,741	*660*	**1,718**	*648*

16. CREDITORS: amounts falling after more than one year

	Group		Company	
	2005	*2004*	**2005**	*2004*
	£'000	*£'000*	**£'000**	*£'000*
Accruals	**120**	-	**120**	-
Deferred income	**885**	-	**885**	-
	1,005	-	**1,005**	-

17. PROVISIONS FOR LIABILITIES AND CHARGES

Group and Company	Lease Obligations	Leasehold Improvements	Dilapidations	Total
	£'000	£'000	£'000	£'000
At 31 March 2004	-	-	-	-
Charged to profit and loss account	**2,192**	-	**81**	**2,273**
Capitalised in the year	-	**110**	-	**110**
Cash payment in the year	**(105)**	-	-	**(105)**
At 31 March 2005	**2,087**	**110**	**81**	**2,278**

A provision has been recognised for the onerous obligations attaching to the leasehold property formerly occupied by the Accountancy Foundation. The provision has been estimated using current costs and has been discounted to present value at a rate of 3.3%. The provision covers residual lease commitments up to the lease break option.

Provisions have been made for obligations under the lease at Aldwych House. These are to remove the leasehold improvements and return the property at the end of the lease to its original state and to meet the tenant repairing clause for dilapidations.

18. CASH FLOW STATEMENT - RECONCILIATION OF OPERATING RESULT TO NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES

	2004/05	*2003/04*
	£'000	*£'000*
(Deficit) / surplus on ordinary activities before taxation	**(678)**	*(53)*
Interest receivable	**(195)**	*(90)*
Depreciation	**115**	*16*
Release of deferred income	**(94)**	-
Loss on disposal of fixed assets	**8**	-
Increase in debtors	**(188)**	*(28)*
Increase in creditors and accruals	**3,098**	*438*
Net cash inflow / (outflow) from operating activities	**2,066**	*283*

19. COMMITMENTS

There were no capital commitments outstanding at 31 March 2005 (2004: nil).

At the balance sheet date the annual commitment for the Group and the Company relating to the Accountancy Foundation leasehold property was £421,000 (2004: £119,811) and has been provided for (see note 5). This lease extends beyond five years.

Annual commitments for the Group and Company under non-cancellable operating leases other those relating to leasehold property are as follows:

	2004/05	2003 / 04
	£'000	£'000
Leases which expire between one and two years	**6**	-

20. SUBSIDIARY UNDERTAKINGS

	Contribute to confidence in corporate reporting and governance by:
The Accounting Standards Board Limited ("ASB")	Establishing and improving standards of financial accounting and corporate reporting.
The Financial Reporting Review Panel Limited ("FRRP")	Seeking to ensure that the provision by public and large private companies of financial information and other information falling within its remit complies with relevant reporting requirements.
The Auditing Practices Board Limited ("APB")	Setting standards and giving guidance: for the performance of external audit and other activities undertaken by accountants that result in reports or other output that is published, required by law or otherwise relied on in the operation of the financial markets; and in relation to the independence, objectivity and integrity of external auditors and the providers of assurance services.
The Accountancy Investigation and Discipline Board Limited ("AIDB")	Providing an independent body to investigate the conduct of members or member firms of the professional accountancy bodies and take disciplinary action in public interest cases - matters which raise or appear to raise important issues affecting the public interest.
The Professional Oversight Board for Accountancy Limited ("POBA")	Strengthening the independence and transparency of the regulatory regime for auditing and for the accountancy profession.

21. LIABILITY OF MEMBERS

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

Annex B - Membership of Council, operating bodies and committees

THE FINANCIAL REPORTING COUNCIL

Chair
Sir Bryan Nicholson GBE

Deputy Chair
The Hon Barbara Thomas Judge

Director

Tim Breedon	Deputy Chief Executive Officer, Legal and General - *from 16 August 2004*
Paul Druckman	President, ICAEW - *from 1 July 2004*
Sir John Egan	President of the CBI - *to 31 May 2004*
David Illingworth	President, ICAEW - *to 30 June 2004*
John Sunderland	President of the CBI and Chairman, Cadbury Schweppes plc - *from 1 June 2004*

Members

Paul Boyle (ex officio)	Chief Executive, FRC
Sir John Bourn KCB (ex officio)	Chair, POBA
Richard Fleck (ex officio)	Chair, APB
Mike Fogden CB (ex officio)	Chair, AIDB
Mary Keegan (ex officio)	Chair, ASB - *to 31 July 2004*
Bill Knight (ex officio)	Chair, FRRP
Ian Mackintosh (ex officio)	Chair, ASB - *from 1 August 2004*
Charles Allen-Jones	Formerly Senior Partner, Linklaters
Scott Bell	Formerly Group Managing Director, The Standard Life Assurance Company - *to 30 June 2004*
Sir Victor Blank	Chairman, GUS plc and Chairman of Trinity Mirror plc
Sir John Bond	Group Chairman, HSBC Holdings plc - *to 9 November 2004*
Martin Broughton	Chairman, British American Tobacco plc - *to 31 May 2004*
Sir David Clementi	Chairman, Prudential plc
Don Cruickshank	Formerly Chairman, London Stock Exchange
Michael Foot	Managing Director, Deposit Takers & Markets Directorate, Financial Services Authority - *to 30 June 2004*
Stephen Haddrill	Director General, Fair Markets Group, Department of Trade and Industry - *to 31 March 2005*
Sir Derek Higgs	Senior Advisor in the UK, UBS Investment Bank
Baroness Sarah Hogg	Chairman, 3i Group plc - *from 1 October 2004*

Douglas Kerr	Group Finance Director, CPL Industries Ltd
Sir George Mathewson CBE	Chairman, The Royal Bank of Scotland Group plc - *from 10 November 2004*
Rory Murphy	Joint General Secretary, UNIFI
Richard Pearson	Senior Partner, PKF - *to 14 November 2004*
Colin Perry	Chairman, LTE Scientific Ltd
Ian Robertson	Group Chief Executive, Wilson Bowden plc and President of ICAS - *from 1 December 2004*
Sir Nigel Rudd	Chairman, Boots Group plc and Pilkington plc
Hector Sants	Managing Director, Wholesale & Institutional Markets Directorate, Financial Services Authority - *from 1 July 2004*
Vincent J Sheridan	Chief Executive, VHI Healthcare
Rosemary Thorne	Group Finance Director, Bradford & Bingley plc
Lindsay Tomlinson	Managing Director and Vice-Chairman, Barclays Global Investors, Europe - *from 1 September 2004*
Graham Ward CBE	Senior Partner Global Energy and Utilities, PricewaterhouseCoopers LLP
Anthony Watson	Chief Executive, Hermes Pensions Management Ltd - *from 1 September 2004*

Observers

Dr Clive Grace	Director General, Audit Commission in Wales - *from 1 September 2004*
Mary Keegan	Managing Director, Government Financial Management, HM Treasury - *from 1 September 2004*
Sir Andrew Likierman	Formerly, Managing Director, Financial Management Reporting and Audit, HM Treasury, and Head of the Government Accountancy Service - *to 31 August 2004*
Ian Michael	Advisor for Accounting Issues, Financial Industry and Regulation Division, Bank of England - *from 27 May 2004*
Ian Morris	Deputy Chairman CCAB, Deputy President, ICAEW - *from 16 August 2004*

Secretary

Michael Lewington

The number of meetings individual Council members attended out of those which they were eligible to attend was as follows:

Sir Bryan Nicholson GBE	4/4	Don Cruickshank	3/4
The Hon Barbara Thomas Judge	4/4	Michael Foot	1/1
Tim Breedon	3/3	Stephen Haddrill	3/4
Paul Druckman	3/3	Sir Derek Higgs	4/4
David Illingworth	1/1	Baroness Sarah Hogg	2/2
John Sunderland	2/4	Douglas Kerr	4/4
Paul Boyle	4/4	Sir George Mathewson CBE	1/2
Sir John Bourn KCB	3/4	Rory Murphy	2/4
Richard Fleck	4/4	Richard Pearson	1/2
Mike Fogden CB	4/4	Colin Perry	3/4
Mary Keegan	1/1	Ian Robertson	1/2
Bill Knight	4/4	Sir Nigel Rudd	1/4
Ian Mackintosh	3/3	Hector Sants	3/3
Charles Allen Jones	3/4	Vincent Sheridan	2/4
Scott Bell	0/1	Rosemary Thorne	3/4
Sir Victor Blank	4/4	Lindsay Tomlinson	2/3
Sir John Bond	0/2	Graham Ward CBE	3/4
Sir David Clementi	3/4	Tony Watson	1/3

COMMITTEE ON CORPORATE GOVERNANCE

Sir Bryan Nicholson GBE
The Hon Barbara Thomas Judge
Charles Allen-Jones
Tim Breedon
Sir Derek Higgs
Colin Perry
Sir Nigel Rudd
Graham Ward CBE

THE ACCOUNTING STANDARDS BOARD

Chair	
Mary Keegan	- *to 31 July 2004*
Ian Mackintosh	- *from 1 August 2004*
Members	
Mike Ashley	Partner, KPMG LLP
Douglas J Flint	Group Finance Director, HSBC Holdings - *to 31 December 2004*
Anthony Good	Independent Equity Research Consultant - *from 1 September 2004*
Huw M Jones	Director of Corporate Finance, M&G Investment Management - *to 31 August 2004*
Andrew Lennard	Technical Director, ASB
Roger Marshall	Partner, PricewaterhouseCoopers LLP
Isobel Sharp	Partner, Deloitte & Touche LLP
John Smith	Director of Finance, Property and Business Affairs, British Broadcasting Corporation - *to 30 November 2004*
Jonathan Symonds	Chief Financial Officer, AstraZeneca plc
Peter Westlake	UK Head of Research, Deutsche Asset Management - *from 1 September 2004*
Observers	
Allan Cook CBE	Member of the EFRAG's Technical Expert Group - *to 31 March 2005*
Mary Keegan	Managing Director, Government Financial Management at HM Treasury - *from 1 September 2004*
Bernadette Kelly	Director, Corporate Law & Governance, DTI
Sir Andrew Likierman	Formerly, Managing Director, Financial Management Reporting and Audit, HM Treasury, and Head of the Government Accountancy Service - *to 31 August 2004*
Professor Geoffrey Whittington CBE	Liaison member of the International Accounting Standards Board
Secretary	
David Loweth	

AUDITING PRACTICES BOARD

Chair	
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Members	
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Jon Grant	Executive Director, Auditing Practices Board
Lew Hughes CB	Formerly Assistant Auditor General, UK National Audit Office
Gill Laver	Director of Finance and Central Services of the Archbishops' Council of the Church of England
Sean Murray	Partner, Conlan Crotty Murray & Co, Dublin - *to 31 March 2005*
Keith Nicholson	Partner, KPMG LLP
Graham Pimlott	Non-Executive Director of Provident Financial plc and Deputy Chairman of Hammerson plc
Ian Plaistowe	Former Partner Arthur Andersen - *to 31 March 2005*
Minnow Powell	Partner, Deloitte & Touche LLP
Will Rainey	Partner, Ernst & Young LLP
David J Thomas	Group Controller, Invensys plc
Tom Troubridge	Head of London Capital Markets Group, PricewaterhouseCoopers LLP - *from 1 September 2004*
Stuart Turley	Professor of Accounting, University of Manchester
Graham Ward CBE	Senior Partner, Global Energy and Utilities, PricewaterhouseCoopers LLP - *to 30 September 2004*
Representative (non-voting)	
Ian Drennan	Chief Executive Officer, Irish Auditing & Accounting Supervisory Authority
Gordon Innes	Deputy Assistant Director, Corporate Law & Governance Directorate, DTI
Richard Thorpe	Financial Services Authority

PROFESSIONAL OVERSIGHT BOARD FOR ACCOUNTANCY

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Tim Barker	Director, Drax Group Ltd and Electrocomponents plc. Chairman Robert Walters plc. Formerly Vice Chairman of Dresdner Kleinwort Benson
David Crowther	Formerly Senior Partner, PricewaterhouseCoopers LLP, responsible for quality assurance and risk management. Director, TT Electronics plc. Member of the Board of the Financial Ombudsman Service - *from 1 July 2004*
Roger Davis	Formerly Head of Professional Affairs, PricewaterhouseCoopers LLP Member of the Competition Commission
Stella Fearnley	Professor of Accounting, University of Portsmouth
Paul George (ex-officio)	Director, POBA
Gareth Jones	Formerly Managing Director Wholesale Banking, Abbey National plc - *to 31 December 2004*
Michael Jones	Head of Management Services & Administration, Trades Union Congress
Anne Maher	Chief Executive, The Pensions Board for Ireland. Board member of the Irish Accounting and Auditing Supervisory Authority
Sarah Wood	Director of Economic and Environmental Policy, Local Government Association - *to 31 December 2004*

Secretary
John Grewe

THE FINANCIAL REPORTING REVIEW PANEL

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Bill Knight	Formerly Senior Partner, Simmons & Simmons

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Gordon Hamilton	Partner, Deloitte & Touche LLP
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Richard Murley	Director General - Panel on Takeovers and Mergers, Goldman Sachs International - *from 1 August 2004*
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Brian Pomeroy	Management Consultant, formerly Senior Partner, Deloitte Consulting - *from 1 August 2004*
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George Rose	Finance Director, BAE Systems plc
Rosemary Thorne	Group Finance Director, Bradford & Bingley plc
Colin Walklin	Director, Group Finance, Barclays plc - from 1 August 2004
Tony Wedgwood	Formerly Partner, KPMG

Secretary

Carol Page	Director, Panel Operations

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Elizabeth Llewellyn-Smith CB	Formerly Department of Trade and Industry and Office of Fair Trading, then Principal of St Hilda's College, Oxford
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David Thomas	Principal Ombudsman (Corporate Director) of the Financial Ombudsman Service

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Anne McArthur

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Rona Fairhead	Chief Financial Officer, Pearson plc
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Geoffrey Mitchell	Director, Financial Projects, Barclays plc
David Nish	Finance Director, Scottish Power plc
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Robert Overend	Technical Partner, Ernst & Young LLP
Brian Shearer	Technical Partner, Grant Thornton
Andy Simmonds	Technical Partner, Deloitte & Touche LLP
Andrew Vials	Partner, KPMG LLP
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David Loweth	Secretary, ASB

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Liam McQuaid	Partner, Duignan Carthy O'Neill
Dr Richard Roberts	Head of SME Research, Barclays plc
Danielle Stewart	Partner, Warrener Stewart
Observer	
Valerie Carpenter	Company Law and Investigations Directorate, Department of Trade and Industry
Secretary	
Duncan Russell	Project Director, ASB

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Rajan Kapoor	Group Chief Accountant, Royal Bank of Scotland plc
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Derek Stevens	Formerly Chief Financial Officer, British Airways plc

Observer

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Simon Peerless	Project Director, ASB

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Michael Hathorn	Partner, Moore Stephens
Lynn Hine	Director, PricewaterhouseCoopers LLP
Richard Laughlin	Professor of Accounting, King's College London
Pam Nelson	Director of finance, London Metropolitan University
Sean Nolan	Director of Corporate Resources, East Sussex County Council
John Stanford	Assistant Director Technical & International, Chartered Institute of Public Finance and Accountancy
Steve Warren	District Auditor, Audit Commission
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Raymond Jones	Senior Accountant, Charity Commission for England and Wales
David Watkins	Accounting Policies Manager, Central Accountancy Team, HM Treasury
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Julian Hance	Former Group Finance Director, Royal and Sun Alliance Insurance Group plc
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Philip Broadley	Group Finance Director, Prudential plc
Andrew Crean	Managing Director Insurance, European Equity Research, Citigroup Smith Barney
Philip Easter	Managing Director Group Finance, Aviva plc
Andrew Lennard	Technical Director, Accounting Standards Board
Peter Needleman	Life Practice Director, Tillinghast
Chris Nunn	Member of the Urgent Issues Task Force, former Technical Partner of Andersen
Paul Sharma	Head of Prudential Risks and Accounting, Financial Services Authority
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ADVISORY COMMITTEE ON THE OFR

Chair	
Anthony Good	Independent Equity Research Consultant and ASB Member
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Mike Corless	Global Head of Equity Research, HSBC Asset Management Ltd
Deborah Doane	Chair, Corporate Responsibility (CORE) Coalition
Guy Elliott	Finance Director, Rio Tinto plc
Margaret Ewing	Group Finance Director, BAA plc
David Morris	Company Secretary, GUS plc
Professor Andy Neely	Centre for Business Management, Cranfield School of Management
Andrew Tusa	Head, Corporate Governance, Deutsche Asset Management
Janet Williamson	Policy Officer, Trades Union Congress
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Chair

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Kevin Desmond	Director, PricewaterhouseCoopers LLP
Laura Gallagher	Partner, KPMG (Dublin)
Stephen Hextall	Director, Transaction Advisory Services, Ernst & Young
Dudley Hilton	Director, Deloitte & Touche LLP
Peter Hughes	Partner, KPMG LLP
Malcolm Lombers	Partner, corporate, Herbert Smith
Susan Nyman	Director, Grant Thornton
Graham Pimlott	Non-Executive Director of Provident Financial plc, Deputy Chairman of Hammerson plc and member of APB
Jeff Ward	Client Partner and Head of Transaction Support, Vantis Numerica Corporate Finance Ltd

INTERNATIONAL COMMITTEE

Chair

Will Rainey	Member of the International Auditing and Assurance Standards Board and the APB

Members

Jon Grant	Technical Advisor to Will Rainey and Executive Director of the APB

Representatives of Accountancy Bodies:

John Brace	The Association of Chartered Certified Accountants
Michael Hughes	The Institute of Chartered Accountants in Scotland
Martyn Jones	The Institute of Chartered Accountants in England and Wales
Richard Mallet	The Chartered Institute of Management Accountants
Ronan Nolan	The Institute of Chartered Accountants in Ireland
Martin Sinclair	The Chartered Institute of Public Finance and Accountancy

PUBLIC SECTOR SUB-COMMITTEE

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John Dowdall	Comptroller and Auditor General, Northern Ireland Audit Office
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Russell Frith	Director of Audit Strategy, Audit Scotland
Rita Greenwood	Executive Director, Finance and Planning, London Borough of Havering
Nigel Johnson	Partner, Deloitte & Touche LLP
David Richards	Principal Finance Officer, National Assembly for Wales
Martin Sinclair	Assistant Auditor General, National Audit Office
Observer	
David Cruden	HM Treasury

OTHER FRC COMMITTEES

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Members	
Stuart Bridges	Group Finance Director, Hiscox plc
John Coombe	Formerly Chief Finance Officer, GlaxoSmithKline plc
Michael Hughes	UK Chairman of Audit, KPMG LLP
Rosemary Martin	General Counsel and Company Secretary, Reuters Group PLC
Michael McLintock	Chief Executive, The M&G Group
John Mew	Executive Partner, Grant Thornton UK
Graham Pimlott	Non-Executive Director of Provident Financial plc and Deputy Chairman of Hammerson plc
Alec Richmond	Head of Group Audit, Cadbury Schweppes plc
Paul Walsh	Chief Executive Officer, Diageo plc
Anthony Watson	Chief Executive, Hermes Pension Management Ltd
Secretary	
Robert Hodgkinson	ICAEW
Assistant Secretary	
Jonathan Hunt	ICAEW (Assistant Secretary)
Observers	
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Stephen Spivey	Department of Trade and Industry

FRC STANDING ADVISORY GROUP ON PROACTIVITY

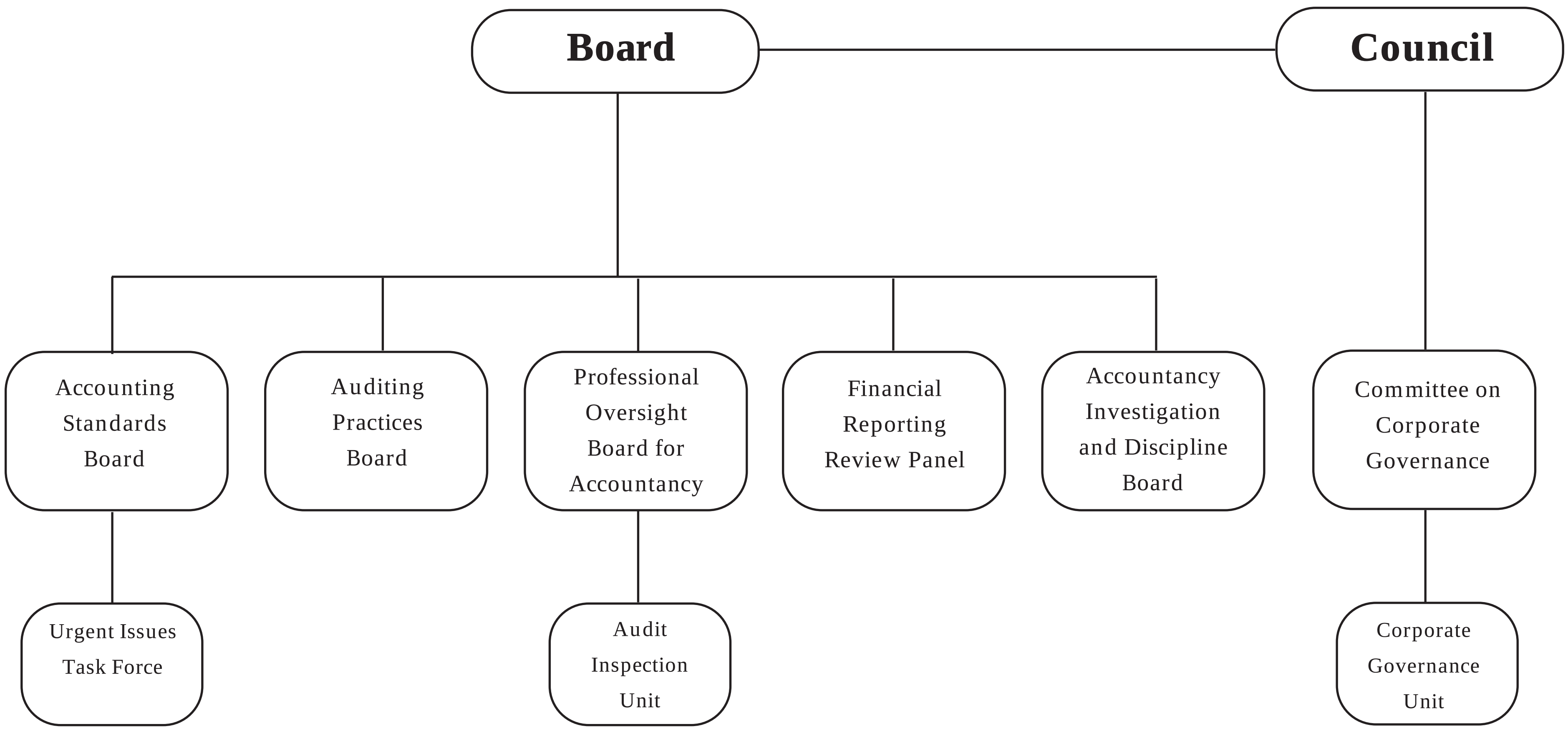
Chair

Bill Knight	Chair, FRRP

Members

Eric Anstee	Chief Executive, The Institute of Chartered Accountants in England and Wales
Kari Hale	Director, Finance Strategy and Risk Division, Financial Services Authority
Alastair Ross Goobey	Chairman of the International Corporate Governance Network
Richard Greenhalgh	Formerly Chairman Unilever UK
Huw Jones	Director of Corporate Finance, M&G Investment Management Ltd
Richard Lambert	Formerly editor, Financial Times; Member, Bank of England Monetary Policy Committee
David Knox	Managing Director – Equities, Head of European Research, Cazenove
Lynn Pearcy	Technical Partner, KPMG LLP
Christopher Rawlins	Director, Policy Co-ordination, Markets and Policy Initiatives Division, Office of Fair Trading
Andrew Watchman	Accountancy Advisor, Department of Trade and Industry

Annex C - Organisational structure



Annex D - Abbreviations

ACCA	Association of Chartered Certified Accountants
AIDB	Accountancy Investigation and Discipline Board
AIU	Audit Inspection Unit
APB	Auditing Practices Board
ARC	Audit Registration Committee
ASB	Accounting Standards Board
C(AICE)	Companies (Audit, Investigations & Community Enterprise) Act
CBI	Confederation of British Industry
CCAB	Consultative Committee of Accountancy Bodies
CESR	Committee of European Securities Regulators
CGU	Corporate Governance Unit
DTI	Department of Trade and Industry
EFRAG	European Financial Reporting Advisory Group
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FRS	Financial Reporting Standard
FRSSE	Financial Reporting Standard for Smaller Entities
FSA	Financial Services Authority
HMT	Her Majesty's Treasury
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI	Institute of Chartered Accountants in Ireland
ICAS	Institute of Chartered Accountants of Scotland
IFRS	International Financial Reporting Standard
IFRIC	International Financial Reporting Interpretations Committee
ISA	International Standard on Auditing
MoU	Memorandum of Understanding
OFR	Operating and Financial Review
PCAOB	Public Company Accounting Oversight Board
POBA	Professional Oversight Board for Accountancy
RED	Reporting standard Exposure Draft
RIA	Regulatory Impact Assessment
SAS	Statement of Auditing Standards
SFO	Serious Fraud Office
SIR	Statement of Investment Circular Reporting Standard
UITF	Urgent Issues Task Force

Annex E - Contact details

Questions about the Annual Report should be sent to:

Enquiries
Financial Reporting Council
5th Floor, Aldwych House,
71–91 Aldwych
London
WC2B 4HN

e-mail: enquiries@frc.org.uk

Telephone: 020 7492 2300
Fax: 020 7492 2301

For general information about the work of the FRC, please see our website at: www.frc.org.uk.

For any further enquiries, please contact us at the above address.

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