FRC

Financial Reporting Council

Proposals for future arrangements for funding the FRC's activities in relation to accounting, auditing and corporate governance

Consultation Paper

July 2008

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One – Introduction and executive summary

Introduction

The FRC is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

Our functions are exercised principally by our Operating Bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy and Actuarial Discipline Board) and the FRC Board.

This document needs to be read in the context of our Regulatory Strategy, which explains our role, responsibilities, governance and accountability. It includes our Strategic Framework (replicated in Annex A) which sets out the outcomes we believe contribute to confidence in corporate reporting and governance. The Regulatory Strategy is available on our website at: http://www.frc.org.uk/about.

For some years the Government has contributed, by way of a grant, a third of the cost of our core operating activities in relation to accounting, auditing and corporate governance. On 6 February, the Government announced that these responsibilities should in future be funded largely by market participants. In order to allow an orderly transition to stable, new long-term funding arrangements, the Government has confirmed that it will continue to make a substantial contribution (£3.5m) to our costs for at least the 2008/09 financial year. The Government asked us to consult market participants on the options for new arrangements to fund our core operating costs in relation to our responsibilities for accounting, auditing and corporate governance.

We are responding to the Government request in two stages:

- Issuing this paper consulting on the principles on which our funding for our core operating costs in relation to our responsibilities for accounting, auditing and corporate governance should be based, and our preliminary views on how we propose to implement those principles.
- In autumn 2008, issuing a further paper reporting on the feedback we have received and setting out our detailed proposals.

The Government's decision to withdraw its current contribution to our funding has required us to consider:

- which organisations should contribute to our costs
- a proposed basis for contributions from each funding group.

Section two of this paper sets out our current arrangements for funding our core operating costs in relation to accounting, auditing and corporate governance and the broad principles we propose to follow in our funding arrangements.

Section three sets out our proposals for two additional major groups which we believe should in future contribute to these costs.

Section four explains the basis on which we propose to set the contributions from each funding group.

Section five sets out our proposal for strengthening the resilience of our finances.

We have not proposed any changes to the current arrangements for funding the FRC's audit inspection or accountancy disciplinary case costs (which are entirely funded by the accountancy professional bodies) or for our responsibilities for actuarial standards and regulation (which are funded by insurance companies, pension schemes, including public sector schemes, and the actuarial professional bodies). These arrangements are outside the scope of the issues being consulted on in this paper but are part of the context for the consultation.

Our current funding arrangements and proposed principles

Our current funding arrangements

Under our present arrangements, we raise funds from two funding groups (in addition to the Government grant):

- The accountancy professional bodies on behalf of the accountancy profession - based on a long-standing agreement between the FRC and the Consultative Committee of Accountancy Bodies (CCAB) under which the CCAB contributes an agreed proportion of the cost of our core operating activities in relation to accounting, auditing and corporate governance each year.
- Publicly traded companies – based on an annual levy on individual companies on which we consult publicly each year. The levy is set each year on the basis of a minimum charge and further charges based on the market capitalisation of each company.

In order to allow an orderly transition to stable, new long-term funding arrangements, the Government has confirmed that it will continue to make a substantial contribution (£3.5m) to our costs for at least the 2008/09 financial year.

At present the FRC raises the UK share of IASB costs. We intend to continue to collect the IASB funding requirement from all of the funding groups which prepare financial statements.

Our proposed principles

We believe that our funding arrangements should continue to provide a fair, cost-effective and stable basis for us to raise the funds we require. We will continue to operate on the basis of our commitment to the principles of good regulation and ensure that we are transparent, proportionate and cost-effective, and consult on a timely basis.

We are committed to securing value for money in all our expenditure, but we believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs. We believe that we have consistently met this commitment and that our new governance arrangements will reinforce our commitment to effectiveness and efficiency.

We believe that we should continue to consult on the resources we require each year on the basis of our assessment of the current risks to confidence in corporate reporting and governance in the UK and our proposed response; but we are considering whether we can provide stakeholders with a meaningful and sufficiently reliable longer term view of our likely funding requirements.

We believe that the principle on which our funding should be based is that our costs should be met by the major groups of market participants which are subject to, or have regard to, our regulatory requirements and have the primary responsibility for implementing the standards we set or influence, monitor and enforce.

We have considered whether we should raise funds from the other main beneficiaries of our regulatory activities, primarily investors, pensioners and policyholders. However, a wide range of groups benefit either directly or indirectly from our work and the population of these groups is very dynamic, making it difficult to clearly identify which groups should contribute. Investors, pensioners and policyholders will in practice contribute through the companies they own or invest with.

Although there are existing powers for our funding to be put on a statutory basis, it is our intention to continue to raise our funds on a non-statutory basis based on the widespread support in the business, investor and professional communities for our work.

Our approach

The Government decision to withdraw its grant towards our core operating activities in relation to accounting, auditing and corporate governance requires us to raise an equivalent amount from other funding groups.

In order to replace the Government grant and enable us to continue to discharge our statutory and other functions, we have:

- Identified potential additional funding groups - organisations which are subject to, or have regard to, our regulatory requirements and have the primary responsibility for implementing the standards we set or influence, monitor and enforce, but which do not currently contribute to our costs and should in future be asked to do so.
- Assessed the amount these additional funding groups might reasonably be asked to contribute based on the application of our present levy arrangements but taking into account the different characteristics of these groups.
- Proposed that the benefits of contributions from the additional funding groups should be shared equally between our two existing funding groups (publicly traded companies and the accountancy professional bodies).

Which additional groups should contribute to our costs

We have identified two additional groups of preparers of financial statements which are subject to, or have regard to, our regulatory requirements and have the primary responsibility for implementing the standards we set or influence, monitor and enforce, but which do not currently contribute to our funding:

- large private companies, which are subject to a range of FRC regulatory requirements
- public sector organisations, which have regard to the accounting and auditing standards which we set or influence.

We believe that by seeking a contribution from these additional groups we will spread our costs more fairly.

Proposed contributions from the additional funding groups

We have taken as our starting point the present funding arrangements and considerations of fairness and cost-effectiveness.

We have identified the number and size of individual entities within each funding group and assessed the appropriate contributions from large private companies and public sector organisations by reference to the levy on publicly traded companies (our business levy) which we currently operate.

Our business levy is based on a minimum levy and further amounts payable by companies above a certain size, with the rate per £m of market capitalisation declining in five levy size bands. The levy size bands are those used by the London Stock Exchange and the FSA for the purposes of their fees.

In order to assess the levy which the entities in the proposed additional funding groups might be asked to pay we have taken account of the different characteristics of each group and the diversity of the entities within each group.

Data on market capitalisation is not available for private companies or public sector organisations. We have, therefore, applied the business levy rates using published data on turnover (for large private companies) and overall expenditure (for public sector organisations where turnover measures are not available) as the basis for calculating the levies that might apply to these entities.

We believe that it would be appropriate to apply a 50% discount to the levy for large private companies to reflect the fact that not all our regulatory activities apply to this group. This is in line with the discount we currently apply to all publicly traded companies other than UK companies listed on the London Stock Exchange Main Market.

We believe that it would be appropriate to apply a discount of 75% to the levy for public sector organisations to reflect the fact that not all our regulatory activities apply to this group and also that the public sector is not directly subject to FRC regulation but in setting its own accounting and audit standards, it has regard to the accounting and auditing standards which we set or influence.

Proposed contributions from our existing funding groups

At present the accountancy professional bodies and publicly traded companies each contribute in equal proportions to our costs for our core operating activities in relation to accounting, auditing and corporate governance. (For 2008/09, each will contribute approximately 35% of these costs.)

The size of the future contributions from publicly traded companies and the accountancy profession will depend on the contribution from the new funding groups.

The impact of our proposals

To illustrate the impact of our proposals we have undertaken some preliminary modelling, using the best data currently available, of the amount that we may be able to secure from the two proposed additional groups if we apply our business levy to each group based on our 2008/09 funding requirement.

In order to meet our 2008/09 funding requirement and share the benefits of the contributions from the additional groups equally between the two existing funding groups it would be necessary to set the levy to be payable by financial statement preparers at a level which is 18% higher than the 2008/09 business levy.

Funding requirement 2008/09 (Accounting, auditing and corporate governance)	**Projected contributions under our proposals**		**Current contributions 2008/09**	
	£'000s	**%**	**£'000s**	**%**
Proposed additional funding groups				
Large private companies	1,250	11	-	-
Public sector organisations	550	5	-	-
Existing funding groups				
Publicly traded companies	5,050	42	4,200	35
Accountancy professional bodies	5,050	42	4,200	35
Government grant	-	-	3,500	30
Total	11,900	100	11,900	100

The resilience of our financial position

We believe that it is prudent to maintain reserves to meet unforeseen changes in the level of our income and expenditure, and in recognition of the fact that we have entered into a number of long-term financial commitments which are necessary to enable us to discharge our regulatory responsibilities efficiently and effectively.

The Government's decision to discontinue its contribution to our core operating costs for accounting, auditing and corporate governance will increase the element of our funding which is provided on a non-statutory basis by market participants, and hence the potential uncertainties in relation to our income. We have also been given greater responsibilities since the current target level of reserves was set, which has increased the likelihood of unexpected developments which might put pressure on our resources. We believe, therefore, that it would be appropriate to increase, over time, the target level of our reserves from £1m to £2m to increase the resilience of our financial position.

Feedback

We would welcome feedback by 5 September 2008 on the issues covered in this paper from all those with an interest in our work to promote confidence in corporate reporting and governance in the UK.

We would particularly welcome the views of the groups we have identified in this document in relation to the FRC's future funding arrangements on the consultation questions set out on pages 9, 17, 23 and 25.

Two – Our current funding arrangements and proposed principles

This section sets out:

- our current arrangements for funding the FRC's core activities in relation to accounting, auditing and corporate governance
- the broad principles we follow in our funding arrangements.

Our current funding arrangements are set out in our Financial Management and Reporting Framework (Annex B).

Our core operating costs in relation to actuarial standards and regulation are funded by the actuarial profession, insurance companies and pension schemes. We receive no grant from the Government in relation to these costs but public sector pension schemes contribute on the same basis as private sector schemes.

Our current funding arrangements – Accounting, auditing and corporate governance

This paper is concerned with the future arrangements for funding those elements of our costs to which the Government currently contributes through an annual grant in aid:

- Core operating costs (accounting, auditing and corporate governance), which cover all our activities in relation to accounting, auditing and corporate governance other than audit inspection, disciplinary case costs and Financial Reporting Review Panel (FRRP) case costs. Our budget for these costs for 2008/09 is £11.9m.
- FRRP case costs, which include only the specific and variable costs of cases which the FRRP decides to take to Court or prepares to take to Court. These costs are met in the first instance from the Review Panel case costs fund, which is then replenished in the following financial year from those organisations which fund our core operating costs. No case costs were incurred in 2007/08 and there is, therefore, no recovery of case costs in our funding requirement for 2008/09.
- Contributions to general reserves in relation to our responsibilities for accounting, auditing and corporate governance. No adjustments to general reserves have been budgeted for 2008/09.

Under current arrangements, our core operating costs in relation to accounting, auditing and corporate governance are funded by the accountancy professional bodies, the business community and the Government.

The Government has agreed to contribute £3.5m in 2008/09. On this basis, we have planned that for 2008/09 the other two funding groups, publicly traded companies and the accountancy professional bodies, will each contribute half of the remaining costs - £4.2m each.

We raise the contribution from the business community through a business levy, which we apply annually following public consultation.

Contribution to the costs of the International Accounting Standards Board (IASB)

We will continue to take the lead on behalf of the UK business community in raising the UK contribution to the cost of the International Accounting standards Board (IASB) by means of the business levy.

The work of the IASB falls directly within the scope of the FRC's national responsibilities. The UK contribution to the IASB for 2008/09 will be £0.7m.

The FRC raises the UK contribution to the cost of the IASB by issuing invoices for the business levy which take this contribution into account.

In the future we believe it would be fairer if all of the funding groups which prepare financial statements (i.e. publicly traded companies and the additional organisations proposed in this paper) contribute towards the IASB's costs. We intend to continue to collect the IASB funding requirement on this basis.

Information about IASB funding is available on the IASB website.

Our proposed principles

We will continue to operate our funding arrangements on the basis of our commitment to the principles of good regulation and ensure that they are transparent, proportionate and cost-effective, and consult on a timely basis.

We are committed to securing value for money in all our expenditure, but we believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs. We believe that we have consistently met this commitment and that our new governance arrangements will reinforce our commitment to effectiveness and efficiency.

We believe that we should continue to consult on the resources we require each year on the basis of our assessment of the current risks to confidence in corporate reporting and governance in the UK and our proposed response; but we are considering whether we can provide stakeholders with a meaningful and sufficiently reliable longer term view of our likely funding requirements.

We believe that the principle on which our funding should be based is that our costs should be met by the major groups of market participants which are subject to, or have regard to, our regulatory requirements, and have the primary responsibility for implementing the standards we set or influence, monitor and enforce.

We have considered whether we should raise funds from the other main beneficiaries of our regulatory activities. However, a wide range of groups benefit either directly or indirectly from our work, making it difficult to clearly identify which groups should contribute on this basis. Investors, members of pension schemes and policyholders, who are significant beneficiaries from our work, will in practice contribute through the companies they own or invest with.

Many of the beneficiaries of our work, for example employees and members of pension schemes, only benefit to the extent that market participants meet the high standards of reporting and governance which we define. We do not believe that it would be appropriate or cost-effective to collect contributions from these wider groups of indirect beneficiaries.

It is our intention to continue to raise our funds on a non-statutory basis based on the widespread support in the business, investor and professional communities for our work. This approach has worked successfully and flexibly since 1990. The Companies (Audit, Investigations and Community Enterprise) Act 2004 provides a power for the Secretary of State to make regulations enabling the FRC to recover our costs through a statutory levy, but we believe that non-statutory arrangements are more flexible and cost-effective.

Consultation question

1. Do you agree that our costs should be met by the major groups of market participants which are subject to, or have regard to, our regulatory requirements, and have the primary responsibility for implementing the standards we set or influence, monitor and enforce?

2. Do you agree that the funding groups which prepare financial statements should contribute towards the UK share of the IASB's costs?

Three – Which groups should contribute to our costs

Proposed additional funding groups

We have identified two additional groups of preparers of financial statements which are subject to, or have regard to, our regulatory requirements and have the primary responsibility for implementing the standards we set or influence, monitor and enforce, but which do not currently contribute to our costs and which, we believe, should in future be asked to do so:

- large private companies, which are subject to a range of FRC regulatory requirements
- public sector organisations, which have regard to the accounting and auditing standards which we set or influence.

The application of the FRC regulatory requirements to these groups is summarised below.

Large private companies

Large private companies in particular (including private equity companies and their portfolio companies and the private subsidiaries of publicly traded companies) are subject to a number of FRC regulatory requirements.

Accounting standards

Directors of companies incorporated under the Companies Acts, including directors of large private companies, are required by law to prepare accounts that give a true and fair view in accordance with the relevant accounting framework (either IFRS or UK GAAP).

The FRC's Accounting Standards Board (ASB) provides a framework for financial and corporate reporting for companies reporting under UK GAAP. The ASB also has a key role in influencing the development and adoption of IFRS. The group accounts of publicly traded companies in the EU are required to be prepared in accordance with IFRS as adopted by the EU. Individual company accounts of publicly quoted companies, however, may be prepared in accordance with either the ASB's accounting standards or IFRS. Private companies generally prepare their accounts in accordance with the ASB's accounting standards, although they also have the option of applying IFRS.

Enforcement of accounting standards

The FRC's Financial Reporting Review Panel (FRRP) looks to ensure that the provision of financial information by large private companies as well as publicly traded companies complies with relevant reporting requirements. The Panel reviews the accounts of publicly quoted companies and any company not qualifying as small or medium-sized as defined by the Companies Acts. It selects accounts for review from the full range of companies within its remit, including large private companies.

The Panel selects accounts for review in accordance with its risk based approach, where risk is measured as a combination of the probability of a breach of accounting requirements and the impact that such a breach would have on the market and investor confidence. On this basis, the Panel has a primary focus on the larger listed companies. However, it also selects accounts from the full range of companies within its remit, including large private companies that fall within the Companies Acts definition.

Since the FRRP adopted a pro-active approach to its reviewing of accounts, approximately 10%-15% of annual accounts reviewed each year have been private companies.

The Panel is also authorised to enforce the requirements of the Companies Act in respect of directors' reports, including the business review, for accounting periods beginning on or after 1 April 2006. This extends to private companies as well.

Auditing standards

The financial statements of private companies, including private equity firms and their portfolio companies, must be audited in accordance with the APB's auditing and ethical standards by audit firms registered with a Recognised Supervisory Body whose activities are overseen by the POB.

Monitoring of audits

Audits of the financial statements of larger private companies are within the scope of independent inspection by the Audit Inspection Unit, which is part of the FRC's Professional Oversight Board (POB).

The POB determines annually which audited entities, in addition to those with listed securities, should be considered to be of major public interest and therefore within the scope of the AIU's work. In addition to UK incorporated companies with a primary listing in the UK, the scope of the AIU's work currently includes private companies in the following categories:

- Unquoted companies / groups of companies in the UK with a group turnover of more than £500m; or group long term debt of more than £250m and turnover of more than £100m
- Unquoted companies or groups which are subsidiaries of foreign parent companies where the turnover of the UK group or company is more than £1,000m

Independent disciplinary arrangements

The FRC's Accountancy and Actuarial Discipline Board (AADB) is the independent, investigative and disciplinary body for accountants and actuaries in the UK.

The AADB 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 an accountant or accountancy firm or an actuary. In investigating important issues affecting the public interest, the AADB will, and has, investigated private companies. Its remit is not limited to public companies.

Contribution to the IASB

Large private companies benefit from the work of the IASB in setting international accounting standards. Even if the accounts are prepared following UK standards, these standards are influenced by the work of the IASB. We believe that it is appropriate that they should make a proportionate contribution to the UK share of the IASB's costs through the FRC's funding arrangements.

Public sector organisations

The FRC's mandate to regulate accounting and reporting in the private sector does not extend to public sector financial reporting arrangements, which are established by HM Treasury. However, while there are important differences in corporate reporting and governance between the private and public sectors, which are reflected in the detail of their reporting and governance arrangements, they share many common principles.

In May 2007, we issued a paper describing the way in which we work with public sector organisations. We add significant value for public sector organisations by:

- setting accounting and auditing standards that can be applied effectively or adapted in the public sector
- promulgating certain standards and guidance that are tailored to the requirements of public sector organisations
- influencing international accounting and auditing standards which are, or are planned to be, used by public sector organisations in the UK and their auditors
- keeping under review the periodic accounts and reports of public bodies with listed securities in the UK
- promoting the professionalism of accountants working in public sector organisations
- operating independent disciplinary arrangements for public interest matters, including matters which might arise in public sector organisations.

Public sector organisations are very diverse, ranging from government departments to small local bodies. National accounts split the sector into three main groups:

- Central government – Government departments, the devolved administrations, executive agencies and health authorities
- Local government
- Public corporations.

The main bodies in each group are shown in Table 1. Each sector has significant regard to accounting and auditing standards set or influenced by the FRC.

Table 1

Body	**Accounting standards applied**	**Audited by**	**Auditing standards applied**
Central Government		*Audit Agencies*	
Ministerial and non-Ministerial departments Executive agencies NHS bodies	UK GAAP (including ASB standards as specified), moving to IFRS	NAO , Audit Scotland, Wales Audit Office and NIAO Audit Commission, Audit Scotland, Wales Audit Office and NIAO	Auditing standards specified by the APB
Local Government		*Audit Agencies*	
Local Authorities, including: London Boroughs, Metropolitan Districts, Unitary Authorities, Shire Councils, Shire Districts, GLA, Police authorities, Fire authorities	UK GAAP (including ASB standards as specified), moving to IFRS	Audit Commission, Wales Audit Office, Audit Scotland and NIAO	Auditing standards specified by the APB
Public corporations		*Audit Agencies*	
• Commercial enterprises controlled by Government	UK GAAP (including ASB standards as specified), moving to IFRS	NAO, Audit Scotland, Wales Audit Office and NIAO	Auditing standards specified by the APB
• Other commercial enterprises (British Energy/Qinetiq)	IFRS	Private firms	

Corporate governance

The Combined Code on Corporate Governance, which the FRC maintains, sets out standards of good practice (for all companies with a primary listing in the UK) in relation to issues such as board composition and development, remuneration, accountability and audit, and relations with shareholders. The Combined Code was revised in response to the Higgs review established by the Government. There are a variety of sources of requirements or guidance on corporate governance in public sector organisations. Most of these sources have adopted a principles-based approach and some have followed the Combined Code's approach of main and supporting principles. Public sector organisations draw on sources of corporate governance in common with the private sector, and monitor developments in the private sector and consider the extent to which lessons can be learnt for the public sector. However, governance arrangements in the public sector can differ from those in the private sector because they are driven by the need for accountability for the use of public funds. The budget for corporate governance comprises a relatively small part of the FRC's core costs.

Accounting standards

The ASB is not responsible for setting the accounting requirements for public sector organisations, although these bodies are required by statute to have regard to UK GAAP.

The Government Resource and Accounts Act 2000 requires Government departments to prepare their resource accounts in accordance with directions issued by HM Treasury having regard to UK GAAP. There is no statutory definition of GAAP but it is at present taken by HM Treasury to be the accounting and disclosure requirements of the Companies Acts, pronouncements by the ASB and the body of accounting knowledge built up over time.

The Financial Reporting Advisory Board (FRAB) established by HM Treasury seeks to promote the highest possible standards in financial reporting by Government and helps ensure that any adaptations of, or departures from, GAAP are justified and properly explained. FRAB includes a member nominated by the ASB. The FRAB advises on the Financial Reporting Manual (FReM) which sets out the accounting and disclosure requirements for the annual reports and accounts of government bodies. The FReM is updated regularly to reflect developments in the accounting standards set by the ASB.

However, this regime is being changed. As announced in the 2007 Budget, in order to follow private sector best practice, the annual financial statements of government departments will be prepared using IFRS adapted as necessary. The 2008 Budget deferred the move to IFRS until to 2009/10. The intention is that Whole of Government Accounts will also be prepared on an IFRS basis from 2009/10.

Local authorities currently prepare UK GAAP-based accounts in accordance with the Code of Practice on Local Authority Accounting in the UK. The local government sector has announced that it will move to preparing IFRS-based accounts from 2010/11 (and is also consulting on whether to move to FRAB based governance arrangements).

In general, public corporations apply UK GAAP in accordance with directions issued by the Treasury, but are moving to IFRS with the rest of the public sector.

The ASB's significant role in relation to IFRS will continue to be highly relevant to public sector organisations. In particular, the ASB will:

- continue to promote the development of appropriate, proportionate and principles-based IFRS
- influence the appropriate adoption of IFRS by the EU through its participation in the European Financial Reporting Advisory Group (EFRAG)
- manage the process of convergence between UK GAAP and IFRS

The Government also contributes to the standard setting process through the policy work undertaken by BERR and HMT, and their work in relevant EU institutions such as the European Securities Committee and the Accounting Regulatory Committee.

The ASB's Committee on Accounting for Public-benefit Entities (CAPE) reviews applications from the public benefit sector seeking to develop Statements of Recommended Practice (SORPs) on accounting matters. CAPE also advises the ASB on its Statement of Assurance for SORP and revisions to SORPs.

Enforcing accounting standards

The FRRP is authorised under the Companies (Audit, Investigations and Community Enterprise) Act 2004 to keep under review periodic accounts and reports that are produced by issuers of listed securities and are required to comply with any accounting requirements imposed by listing rules. This Order brings within the Panel's scope the financial information of public bodies that have listed securities in the UK. The Panel has no power to effect corrective action in respect of this financial information but can report its findings to the FSA. In practice, however, any public bodies that are issuers of listed securities are already likely to be contributing to the costs of the FRC through the business levy.

Auditing standards

The standards governing the conduct and reporting of the audit of financial statements in public sector organisations are a matter for the public audit agencies to determine. However, the heads of the national audit agencies in the UK have chosen to adopt the APB's engagement standards and quality control standards as the basis of their approach to the audit of public sector financial statements.

The Public Audit Forum which brings together the National Audit Office (NAO), the Northern Ireland Audit Office (NIAO), the Audit Commission for Local Authorities and the National Health Service in England (Audit Commission), the Wales Audit Office and Audit Scotland, advises on the application of standards and the practices of auditors delivering public services, having specific regard to the statements issued by the APB.

In January 2006, the APB issued updated guidance for this purpose, taking account of the application of ISAs.

The APB has issued bulletins addressing respectively the role of audit in relation to central government, the NHS and local government. These are based on equivalent guidance for the auditors of listed companies.

Promoting the professionalism of accountants

The professional oversight arrangements operated by the POB apply to members and member firms of the accountancy professional bodies working in or with public sector organisations.

Independent disciplinary arrangements

Our core operating costs include the costs of maintaining the AADB. The independent disciplinary arrangements which the AADB maintains cover members of the accountancy professional bodies which belong to the AADB Accountancy Scheme, including members working in and for public sector organisations. The public sector contributes indirectly to activities such as disciplinary arrangements and the promotion of professionalism where it reimburses the professional fees of accountants working in the public sector.

Contribution to the IASB

Public sector organisations benefit from the work of the IASB in setting international accounting standards which can be applied in the public sector. We believe that it is appropriate that they should make a proportionate contribution to the UK share of the IASB's costs through FRC's funding arrangements.

Our existing funding groups

Our two existing funding groups, publicly traded companies and the accountancy professional bodies, have significant responsibilities for implementing high standards in relation to accounting, auditing and corporate governance.

Publicly traded companies

Publicly traded companies have significant responsibilities arising from FRC regulation in relation to all the matters which apply to large private companies: setting, monitoring and enforcing accounting and auditing standards and independent disciplinary arrangements for public interest cases.

In addition the FRC maintains and promotes the Combined Code on Corporate Governance, and associated guidance, which applies to UK registered companies listed on the Main Market of the London Stock Exchange. The Code sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit, and relations with shareholders.

The accountancy professional bodies

Members of the accountancy professional bodies and accountancy firms in business, audit and advisory roles in the UK are subject to a wide range of FRC regulatory requirements intended to contribute to confidence in their integrity and competence and that they will have regard to the public interest in their work.

Members of the accountancy professional bodies and the firms to which they belong are subject to the requirements of ASB accounting standards and, where appropriate, IFRS in preparing financial reports.

The APB ensures that auditing and ethical standards and guidance provide an effective framework for the conduct of audits.

The POB oversees the regulatory systems which the recognised supervisory and qualifying bodies are required to have in place to support high quality audits. In addition, the POB oversees the arrangements which the accountancy professional bodies have in place to ensure that their members are appropriately qualified and meet high standards in their technical performance and ethical behaviour.

The AADB provides independent arrangements for investigation and discipline in public interest cases involving members of the accountancy professional bodies.

Other potential major funding groups

There are certain other groups which have regard to FRC accounting and auditing standards. These include major UK charities, housing associations and the higher and further education sector. The requirements which apply to individual entities within these groups depend on how they are constituted and the relevant national jurisdiction within the UK.

However, given the fairly limited application of FRC regulation to these groups (and the potential costs involved in establishing new funding arrangements in relation to these groups) we do not believe that it would be appropriate or cost-effective to seek contributions from them.

Consultation questions

3. Do you agree that we have appropriately identified the two major groups which (following the decision to withdraw the Government contribution to our funding) are subject to, or have regard to, our regulatory requirements but which do not contribute to our costs?
4. Are there any other major groups of market participants which, in your view, should contribute to our funding arrangements?

Four – Proposed basis for contributions from each funding group

In order to replace the Government grant and enable us to continue to discharge our statutory and other functions, we have:

- Identified potential additional funding groups - organisations which are subject to, or have regard to, our regulatory requirements and have primary responsibility for implementing the standards we set or influence, monitor and enforce, but do not currently contribute to our costs and should in future be asked to do so.
- Assessed the amount these additional funding groups might reasonably be asked to contribute based on the application of our present levy arrangements but taking into account the different characteristics of these groups.
- Proposed that the benefits of contributions from the additional funding groups should be shared equally between our two existing funding groups (publicly traded companies and the accountancy professional bodies).

Proposed contributions from additional funding groups

We have taken as our starting point the present funding arrangements and considerations of fairness and cost-effectiveness.

We have decided to proceed on the basis of identifying the number and size of individual entities within each funding group and assessing the appropriate contributions from large private companies and public sector organisations by reference to the business levy which we currently apply to publicly traded companies.

The key features of the business levy are:

- a minimum levy
- further amounts payable by companies above a certain market capitalisation, with the rate per £m of market capitalisation declining in five levy size bands (which are identical to those used by the FSA for its UKLA fees).

The minimum levy and the rates for larger companies are calculated based on the number of listed companies and their market capitalisations. The levy payable by companies of any given size will be determined by the decisions on:

- the amount of the minimum levy
- the size limit for companies to which only the minimum levy applies
- the speed at which the rates payable by larger companies decline.

In order to reflect the fact that not all of our activities apply to them, we apply a discount of 50% to the minimum levy and the market capitalisation-based levy rates for publicly traded companies other than UK companies listed on the London Stock Exchange Main Market.

In order to assess the levy which the entities in the proposed additional funding groups might be asked to pay we have taken account of the different characteristics of each group and the diversity of the entities within each group.

Market capitalisation is not available as a measure of the size of private companies or public sector organisations. We have, therefore, applied the business levy rates using published data on turnover (for large private companies) and overall expenditure (for public sector organisations where turnover measures are not available) as the basis for calculating the levies that apply to these entities.

Preliminary estimates of contributions from the proposed additional funding groups

To illustrate the impact of our proposals we have undertaken some preliminary modelling, using the best data currently available, of the amount that we may be able to secure from the two proposed additional groups if we apply our business levy to each group based on our 2008/09 funding requirement. In order to meet our 2008/09 funding requirement and share the benefits of the contributions from the additional groups equally between the two existing funding groups it would be necessary to set the levy to be payable by financial statement preparers at a level which is 18% higher that the 2008/09 business levy.

We believe that it would be appropriate to apply a 50% discount to the levy for large private companies to reflect the fact that not all our regulatory activities apply to this group, including our work in relation to corporate governance and the implementation of the EU Directive on Statutory Audit. This is in line with the discount we currently apply to all publicly traded companies other than UK companies listed on the London Stock Exchange Main Market.

We believe that it would be appropriate to apply a discount of 75% to the levy for public sector organisations. This reflects the fact that, as with large private companies, not all of the FRC's regulatory activities apply to this group. It also reflects the fact that the public sector is not directly subject to FRC regulation, setting its own accounting and audit standards, and meeting the costs of this activity. But in setting these standards, the public sector has regard to the accounting and auditing standards which the FRC is responsible for setting or helps influence. It also takes account of the difficulty in determining the degree to which the public sector benefits from activity the FRC is required to undertake.

We have taken account of the UK contribution to the IASB in estimating the contribution from both the proposed additional funding groups.

We have also considered the costs of collecting the levy from the two groups.

Proposed contribution from large private companies

We have assessed the potential contribution from those large private companies with a turnover of more than £500m.

Table 2 estimates the size of this group in terms of the number of companies and their turnover.

Table 2

Companies	Total Turnover (£m)	Average Turnover (£m)
1 to 50	591,000	11,820
51 to 100	180,000	3,600
101 to 150	115,000	2,300
151 to 200	87,000	1,740
201 to 250	70,000	1,400
251 to 300	58,000	1,160
301 to 350	50,000	1,000
351 to 400	43,000	860
401 to 450	39,000	780
451 to 500	35,000	700
501 to 550	33,000	660
551 to 600	30,000	600
601 to 650	28,000	560
651 to 700	27,000	540
Total	1,386,000	n/a

Taking account of the proposed 50% discount and the necessary collection costs, we believe that the contribution to our costs would be in the order of £1,250k. We believe that the appropriate contribution to the UK share of the IASB's costs for this group would be £130k.

In preparing our detailed proposals for collecting a contribution from this group we will need to develop a robust definition of the range of entities we wish to include, a database identifying the entities within an agreed size range for the purpose of collecting contributions from individual entities, and cost-effective collection arrangements.

The estimate includes private limited entities which are subsidiaries of publicly traded companies. We have not proposed to explicitly seek a contribution from private equity companies, but it is likely that the range of entities we define will include a number of private equity or private equity-owned companies.

We believe that it would be cost-effective to establish arrangements to collect a contribution from large private companies, taking account of the fact that a smaller portion of activities apply to them than to publicly traded companies. We will need to consider carefully the size criteria to ensure that the proposed collection method is cost effective.

In relation to small private companies, the number of companies involved and the absence of an existing mechanism for defining the population and allocating and collecting contributions means that we are not likely to be able to establish cost-effective arrangements to collect contributions.

Proposed contribution from public sector organisations

We have assessed the potential contribution from significant public sector organisations which use accounting and audit standards that have regard to the accounting and auditing standards which the FRC sets or influences.

Table 3 shows the size of the different types of public sector organisation in terms of the number of organisations and overall turnover, which could provide a basis for allocation. However, these are indicative estimates and agreeing the final basis of allocation would be a matter for the Government.

Table 3

Type of body	**Number of bodies**	**Size (£m)**
Central Government		
Departmental Groups	22	493,000
Executive agencies	22	61,000
Foundation Trusts	59	10,000
Primary Care Trusts	151	74,000
Local government		
Local Authorities	469	103,550
Police Authorities	50	13,400
Fire Authorities	42	2,480
Public corporations		
Commercial enterprises controlled by Government	43	44,000
Other commercial enterprises (British Energy Group/Qinetiq)	2	4,000
Total	**860**	**n/a**

Taking account of the proposed 75% discount, we believe that the contribution to our costs from this group would be in the order of £550k. We believe that the appropriate contribution to the UK share of the IASB's costs for this group would be £50k.

Proposed contribution from existing funding groups

At present the accountancy professional bodies and publicly traded companies each contribute in equal proportions to our costs for our core operating activities in relation to accounting, auditing and corporate governance. (For 2008/09, each will contribute approximately 35% of these costs.)

The size of the future contributions from publicly traded companies and the accountancy profession will depend on the contribution from the new funding groups.

The impact of our proposals

Table 4 summarises the impact of our proposals for the two proposed additional funding groups and the two existing funding groups if we apply the discounted levy to each group based on our 2008/09 funding requirement. In order to meet our 2008/09 funding requirement and share the benefits of the contributions from the additional groups equally between the two existing funding groups it would be necessary to set the levy to be payable by financial statement preparers at a level which is 18% higher than the 2008/09 business levy.

Table 4

Funding requirement 2008/09 (Accounting, auditing and corporate governance)	**Projected contributions under our proposals**		**Current contributions 2008/09**	
	£'000s	**%**	**£'000s**	**%**
Proposed additional funding groups				
Large private companies	1,250	11	-	-
Public sector organisations	550	5	-	-
Existing funding groups				
Publicly traded companies	5,050	42	4,200	35
Accountancy professional bodies	5,050	42	4,200	35
Government grant	-	-	3,500	30
Total*	11,900	100	11,900	100

* *Case costs incurred by the FRRP and planned changes in the FRC's general reserves will be included in the funding requirement. The funding requirement for FRRP case costs in 2008/09 is nil and no changes in general reserves are planned in 2008/09.*

We believe that these estimates provide a reasonable indication of the impact of our proposals for the purposes of this initial consultation.

The rates that would apply to a selection of entities in the proposed new funding groups are as follows:

Table 5

Entity	**Turnover (£m)**	**Levy (£)**
Large private company	43,000	11,620
Private subsidiary of a publicly traded company	11,500	11,070
	Expenditure (£m)	**Levy (£)**
Public corporation	810	1,300
Foundation Trust	309	620

In the light of the responses to this consultation, the FRC will carry out further analysis and refine the calculations. We will then issue a second consultation on our final proposals.

Consultation questions

5. Do you agree with our proposed basis for assessing the appropriate contribution from the potential new funding groups we have identified to the costs of our core operating activities in relation to accounting, auditing and corporate governance?
6. Are there additional criteria which, in your view, we should take into account in determining the size of the contribution from these groups?

Five - The resilience of our financial position

The FRC is a non-profit making organisation with no share capital. Our intention in raising funds in relation to all our activities is merely to recover our costs and to ensure that we have an appropriate level of reserves.

We believe that it is prudent to maintain reserves to meet unforeseen changes in the level of our income and expenditure, and in recognition of the fact that we have entered into a number of long-term financial commitments which are necessary to enable us to discharge our regulatory responsibilities efficiently and effectively.

In particular our finances need to be sufficiently resilient to deal with risks related to:

- The non-statutory basis for our funding arrangements. This has enabled us to operate our funding arrangements flexibly and at basis at a modest cost, but increases the risk that unforeseen circumstances will reduce the level of our income in a particular period. Maintaining appropriate reserves will help us to manage the impact of changes to our income and, potentially, reduce the volatility of our funding requirements from the perspective of our stakeholders.
- The nature of our remit, which requires us to respond to unexpected developments which affect confidence in corporate reporting and governance but does not enable us quickly or easily to reduce or delay existing activities and projects.
- The financial consequences of any major changes in the future to the scope of our responsibilities.

In relation to our responsibilities for accounting, auditing and corporate governance, the level of reserves in recent years has been £1.0m but has been kept under review by the Directors, who have undertaken to consult on any proposal to vary the level of the reserves in the context of our annual Plan & Budget.

The Government's decision to discontinue its contribution to our core operating costs for accounting, auditing and corporate governance will increase the element of our funding which is provided on a non-statutory basis by market participants, and hence the potential uncertainties in relation to our income.

In addition, our responsibilities (detailed in our annual Plans) have grown in recent years, increasing the pressure on our resources and hence the potential impact of unexpected developments. Such developments could arise in relation to any aspect of our activity – for example, the need to amend standards or carry out additional monitoring activity in response to unforeseen market developments, a higher than expected volume of investigative or disciplinary work, or matters that require attention in relation to our oversight activities.

We believe, therefore, that we should increase the level of our reserves, over time, to reflect these factors. We will decide on the timing of the reserves increase in the light of our budget and financial position and will consult each year on proposed changes to the level of reserves.

We will continue to consult on the level of our reserves in the context of our annual Plan & Budget but our present assessment is that we should establish a target level of reserves of £2.0m, which we should aim to build up to over the next three years.

Consultation question

7. Do you agree that it is appropriate for us to increase the target level of our reserves to £2m?

Annex A - Strategic Framework

Overall Aim: Confidence in corporate reporting and governance					
Strategic Outcomes which contribute to the Overall Aim:					
Outcome One: Corporate Governance	**Outcome Two: Corporate Reporting**	**Outcome Three: Auditing**	**Outcome Four: Actuarial Practice**	**Outcome Five: Professionalism of accountants and actuaries**	**Outcome Six: FRC Effectiveness**
UK companies with a primary listing in the UK are led in a way which facilitates entrepreneurial success and the management of risk.	Corporate reports contain information which is relevant, reliable, understandable and comparable, and are useful for decision-making, including stewardship decisions.	Users of audit reports can place a high degree of reliance on the audit opinion, including whether financial statements show a true and fair view.	Users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility.	Clients and employers of professionally qualified accountants and actuaries and of accountancy and actuarial firms can rely on them to act with integrity and competence, having regard to the public interest.	The FRC is an effective and independent regulator, actively helping to shape UK, and to influence EU and global, approaches to corporate reporting and governance.

Strategic Outcome One: Corporate Governance **UK companies with a primary listing in the UK are led in a way which facilitates entrepreneurial success and the management of risk.**		
Supporting Outcomes which contribute to the Strategic Outcome (*and primary responsibility for achieving them*):		
Legislative and regulatory framework *(Government and regulatory authorities)*	**Implementation *(Boards of primary listed companies)***	**Monitoring and enforcement (*Institutional shareholders)***
a) The legislative and regulatory framework for corporate governance is clear, proportionate and capable of dealing with a wide variety of circumstances and of adaptation to developments in corporate practices.	b) Boards meet the necessary high standards of performance.	c) Institutional shareholders regard good corporate governance as an essential basis for sustained good performance by companies.
Components which contribute to the achievement of the Supporting Outcomes:		
i) Legislative provisions relating to corporate governance, originating in the UK or in the EU, are effective and proportionate and appropriately implemented.	i) There is an adequate supply of skilled and experienced people willing to serve on Boards.	i) Institutional shareholders support shareholder-led enforcement of standards of corporate governance.
ii) Good governance is defined by a Code of Principles outlining good practice, based on a "comply or explain" approach and kept under regular review. (FRC)	ii) Boards accept the Code as a basis for good practice and willingly seek to meet its standards in a way which is consistent with the long-term health of their companies.	ii) Institutional shareholders support the Code, including "comply or explain", as the best instrument for enforcing good corporate governance in listed companies.
	iii) Companies provide shareholders with information on their governance and performance which is relevant, understandable and balanced.	iii) Institutional shareholders appropriately engage in dialogue with boards on corporate governance matters.
	iv) Boards accept the need to engage with shareholders in dialogue on corporate governance matters.	

Strategic Outcome Two: Corporate Reporting Corporate reports contain information which is relevant, reliable, understandable and comparable, and are useful for decision-making, including stewardship decisions.		
Supporting Outcomes which contribute to the Strategic Outcome *(and primary responsibility for achieving them)*:		
Legislative and regulatory framework *(Government and regulatory authorities)*	**Implementation** *(Directors, trustees, etc)*	**Monitoring and enforcement** *(Regulatory authorities)*
a) The legislative and regulatory framework provides clarity in what is required to provide relevant, reliable, understandable and comparable reports, and underpins the importance of a true and fair view.	b) Directors strive to ensure that financial statements show a true and fair view and to embrace best practice in the provision of all information in financial reports.	c) Financial reporting requirements are appropriately monitored and enforced.
Components which contribute to the achievement of the Supporting Outcomes:		
i) Legislative provisions relating to corporate reporting, originating in the UK or in the EU, are effective and proportionate and appropriately implemented.	i) Directors apply the principles set out in accounting standards responsibly and with integrity and in a way that reflects the underlying economic reality; and disclose and explain the key judgments made in compiling financial statements and other reports.	i) There is an effective and efficient mechanism to ensure compliance with financial reporting requirements – which provides for risk-based targeting of information for review, and encourages open dialogue with companies and informed referrals from the investor community. (FRRP)
ii) Accounting standards provide an effective framework for the preparation of financial reports, are principles-based and serve the public interest. (ASB)	ii) Directors set out a clear and balanced analysis of the development, performance, strategic position and future prospects and direction of their business that enables users to make informed decisions, including an assessment of the Directors' stewardship.	
iii) The standard-setting body plays an influential role in the development of international accounting standards, and plays an influential role in Europe. (ASB)		
iv) The standard-setting body maintains an appropriate and high quality regime for UK accounting standards – which takes account of the size and degree of public interest in the entities to which the regime applies. (ASB)		
v) There is guidance on the meaning of "true and fair" to guide preparers and to maintain confidence in the financial reporting regimes in place. (FRC)		
vi) There is best practice guidance to preparers on aspects of financial reporting not covered by accounting standards, such as narrative reporting. (ASB)		

Strategic Outcome Three: Auditing **Users of audit reports can place a high degree of reliance on the audit opinion, including whether financial statements show a true and fair view.**		
Supporting Outcomes which contribute to the Strategic Outcome ***(and primary responsibility for achieving them)*****:**		
Legislative and regulatory framework ***(Government and regulatory authorities)***	**Implementation** ***(Auditors and audit firms)***	**Monitoring and enforcement** ***(Audit committees and regulatory authorities)***
a) The legislative and regulatory framework provides clarity on the role and purpose of audit and the standards which auditors should meet.	b) Audits are undertaken by an experienced, motivated and sceptical team within an effective firm-wide environment in audit firms and an efficient market for audit services.	c) Auditing requirements are appropriately monitored and enforced.
Components which contribute to the achievement of the Supporting Outcomes:		
i) Legislative provisions relating to auditing, originating in the UK or in the EU, are effective and proportionate and appropriately implemented.	i) Audit provides a rewarding career thus attracting, developing and retaining high quality entrants for the long term stability of the profession.	i) Audit committees know what the main drivers of audit quality are, and are pro-active and effective in undertaking their reviews of audit quality and reporting their findings.
ii) Auditing and ethical standards and guidance provide an effective framework for the expected conduct of audits, are principles-based and serve the public interest. (APB)	ii) Audit firms ensure that audit teams have the capability, competence and time to detect material errors, omissions or irregularities in the financial statements they are auditing - and adhere to the principles on which auditing and ethical standards and guidance are based and not just the rules.	ii) Audit monitoring focuses on the drivers of audit quality and the professional judgements exercised at both the firm-wide and engagement level. (POB)
iii) The standard-setting body plays an influential role in the development of international auditing and ethical standards and plays an influential role in Europe. (APB)	iii) Auditors should report appropriately to shareholders and communicate effectively with audit committees.	iii) The recognised supervisory bodies maintain appropriate arrangements for the monitoring and enforcement of compliance with their rules and for the investigation of complaints. (POB)
iv) There is guidance on the key drivers of audit quality. (FRC)	iv) There is an efficient market for audit services in the UK.	
v) Recognised supervisory and qualifying bodies have effective regulatory systems to support high quality audits.		

Strategic Outcome Four: Actuarial Practice **Users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility.**		
Supporting Outcomes which contribute to the Strategic Outcome *(and primary responsibility for achieving them)*:		
Legislative and regulatory framework ***(Government and regulatory authorities)***	**Implementation (*Actuaries and actuarial firms)***	**Monitoring and enforcement *(Institutional users of actuarial information, regulatory authorities and the actuarial profession)***
a) The legislative and regulatory framework provides clarity on what is required to provide relevant, transparent, clear and complete actuarial information.	b) Actuarial information is provided to a consistently high quality standard.	c) There is effective scrutiny and monitoring to ensure that actuarial information is produced in accordance with the relevant technical and ethical standards.
Components which contribute to the achievement of the Supporting Outcomes:		
i) Legislative provisions relating to actuarial practice, originating in the UK or in the EU, are effective and proportionate and appropriately implemented.	i) Actuaries apply the principles set out in actuarial standards responsibly and with integrity, and in a way that reflects the economic reality.	i) Institutional recipients and users of actuarial information know what the main drivers of quality are, and are pro-active in challenging the quality of the actuarial information they receive.
ii) There is a conceptual framework which sets out the principles and concepts that underlie actuarial information and gives coherence and consistency to the standards. (BAS)	ii) Actuaries communicate clearly the underlying assumptions made and the inherent risks for a range of possible outcomes.	ii) There is a framework of effective scrutiny and monitoring which ensures that actuarial information complies with the relevant technical and ethical standards.
iii) Actuarial standards are developed or amended which are consistent with the conceptual framework (and best practice) and the provision of clear and complete actuarial information. (BAS)	iii) Actuaries supply relevant, reliable and comprehensible information to assist in decision-making by the principal users of actuarial advice.	
iv) Actuarial standards fit appropriately into a framework that includes all relevant regulation (including professional, accountancy and prudential regulators) and take due account of public interest.		

Strategic Outcome Six: FRC Effectiveness The FRC is an effective, accountable and independent regulator, actively helping to shape UK, and to influence EU and global, approaches to corporate reporting and governance.		
Supporting Outcomes which contribute to the Strategic Outcome:		
a) The FRC meets the principles of good regulation, and is transparent and accountable.	b) The FRC is recognised in the UK and globally as independent, credible, authoritative and influential.	c) The FRC has adequate resources and management processes and operates efficiently.
Components which contribute to the achievement of the Supporting Outcomes:		
i) The FRC has in place and consistently implements policies on good regulation, including effective use of regulatory impact assessments and having particular regard to the impact of regulation on small enterprises.	i) The FRC has a statutory framework in place to provide the appropriate powers and statutory immunity, and a clearly documented basis for the non-statutory elements of its responsibilities.	i) The FRC attracts, retains and motivates the people required to meet its objectives.
ii) The FRC publishes an Annual Report which assesses progress towards the achievement of the outcomes included in the Strategic Framework and the FRC's own performance in implementing its annual Plan and meeting the principles of good regulation.	ii) The FRC demonstrates an appropriate degree of independence from government and the regulated communities.	ii) The FRC manages information effectively and shares information as appropriate within the organisation.
iii) Stakeholders are provided with regular reports and other information, such as assessment of the impact of activities designed to achieve the Strategic Outcomes in this framework.	iii) Effective working relationships with UK Government (including BERR, HMT and DWP), and other UK regulators (including FSA and the Pensions Regulator) are maintained.	iii) The FRC secures the necessary funding and manages its costs effectively.
iv) An annual Plan & Budget is published which reflects timely and thorough consultation with stakeholders.	iv) The FRC effectively engages with, and influences, relevant EU and global organisations, and regulatory authorities in other major jurisdictions.	iv) Activities and projects in the Plan & Budget are completed in a timely and effective way and the risks to the achievement of the Strategic Outcomes in this framework are actively managed.
	v) There is a clear statement of the relevance of the FRC's work to the public sector and other public benefit entities.	v) The FRC is resilient to disruptions to its activities.

Annex B - Financial Management and Reporting Framework

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

Accounting, auditing and corporate governance

The Framework identifies four categories of cost in relation to our responsibilities for accounting, auditing and corporate governance:

Core operating activities - Accounting, auditing and corporate governance

- Core operating activities (accounting, auditing and corporate governance) cover all our activities in relation to accounting, auditing and corporate governance other than audit inspection, disciplinary case and Review Panel case costs.
- The costs of the core operating activities are measured in accordance with applicable accounting standards but the amount of funds raised is adjusted for significant non-cash items, principally depreciation and capital expenditure.
- The funds are provided by the FRC's three sponsors: the accountancy profession (the six major professional bodies); the business community (primarily companies listed in the UK); and the Government.
- Our intention is to raise in each financial year the funds expected to be required for that year.

Audit inspection costs

- Audit inspection costs include only the specific and variable costs of the AIU. The AIU's fixed overheads (principally office accommodation and shared IT systems) are included in core operating costs.
- Audit inspection costs are met by the individual Recognised Supervisory Boards with which the firms that are subject to inspection are registered.
- Our intention is to raise in each financial year the costs incurred in that year.

Accountancy disciplinary case costs

- Accountancy disciplinary case costs include only the specific and variable costs of cases taken by the AADB. The other costs of the AADB (principally staff, accommodation, shared IT systems and other overheads) are included in core operating costs.
- Case costs are potentially volatile from year to year, depending on the number and complexity of cases and, therefore, cannot be subject to firm budgetary limits.
- Case costs are met by the individual participating bodies to which the members or firms that are the subject of each case belong. In the event of disciplinary complaints being brought, the disciplinary tribunals have powers to award costs against those found guilty of misconduct.
- Our intention is to raise in each financial year the costs incurred in that year.

Review Panel case costs

- Review Panel case costs include only the specific and variable costs of cases which the FRRP decides to take to Court or prepares to take to Court. The other costs of the FRRP (principally the staff, office accommodation and shared IT systems) are included in core operating costs.
- Case costs are potentially volatile from year to year, depending on the number and complexity of cases and, therefore, cannot be subject to firm budgetary limits. These costs are met in the first instance from the Review Panel case costs fund, which is then replenished in the following financial year on the same basis as the costs of the core operating activities (accounting, auditing and corporate governance).

Actuarial standards and regulation

The Framework identifies two categories of cost in relation to our responsibilities for actuarial standards and regulation.

With the agreement of HM Treasury, these costs are met from an annual contribution from the actuarial profession (10% of total costs) and a levy on insurance companies (45%) and pension funds (45%) - the actuarial funding arrangements.

Core operating costs - Actuarial standards and regulation

- Core operating activities (Actuarial standards and regulation) cover all of our activities in relation to actuarial standards and regulation other than disciplinary case costs. They include a proportion of our overheads.
- The costs of the core operating activities are measured in accordance with applicable accounting standards but the amount of funds raised is adjusted for significant non-cash items, principally depreciation and capital expenditure.
- Our intention is to raise in each financial year the funds expected to be required for that year.

Actuarial disciplinary case costs

- Actuarial disciplinary case costs include only the specific and variable costs of actuarial cases taken by the AADB. The other costs of the AADB (principally staff, accommodation, shared IT systems and other overheads) are included in the two categories of core operating costs in proportion to the relative costs of accountancy and actuarial cases.
- Case costs are potentially volatile from year to year, depending on the number and complexity of cases and, therefore, cannot be subject to firm budgetary limits. We have decided to establish a fund to cover these costs.
- The level of the fund will be kept under review in the light of experience of the number and size of cases.

- The contribution that will be required to maintain the fund at an appropriate level will be reviewed each year.
- Any fine income received or legal costs awarded to the FRC in relation to disciplinary cases will be used to replenish the fund. Should the fund exceed the target level, the excess will be used to meet the FRC's actuarial operating costs, thereby reducing the costs to the funding groups.

Measuring our effectiveness in managing costs

While we endeavour to ensure that we secure value for money in all our expenditure, the Directors believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs.

Reserves

The Directors believe that it is prudent for the FRC to maintain reserves to meet unforeseen expenditure and in recognition of the fact that the FRC has entered into a number of long-term financial commitments.

In relation to our responsibilities for accounting, auditing and corporate governance, the level of reserves in recent years has been approximately £1.0m but is kept under review by the Directors. The Directors have undertaken to consult on any proposal to vary the level of reserves in the context of the annual Plan & Budget.

A separate reserve will be held in relation to our responsibilities for actuarial standards and regulation, built up from the actuarial funding arrangements. A proportion of the surplus may be allocated to the actuarial case cost fund. The Directors will keep the level of actuarial reserves under review and will consult on them each year in the context of the annual Plan & Budget.

Annex C – Abbreviations

AADB	Accountancy & Actuarial Discipline Board
AIU	Audit Inspection Unit
APB	Auditing Practices Board
ASB	Accounting Standards Board
BAS	Board for Actuarial Standards
BERR	Department for Business, Enterprise and Regulatory Reform (formerly DTI)
CCAB	Consultative Committee of Accountancy Bodies
CGU	Corporate Governance Unit
EFRAG	European Financial Reporting Advisory Group
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FSA	Financial Services Authority
HMT	Her Majesty's Treasury
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing
NIAO	Northern Ireland Audit Office
SORP	Statement of Recommended Practice
POB	Professional Oversight Board
UK GAAP	UK Generally Accepted Accounting Practices

Annex D - Contact Details

Responses to this consultation paper should be sent to:

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Unless respondents indicate that they would prefer us not to do so, we will publish responses on our website.

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

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