

9 September 2008

Email: planning@frc.org.uk

Financial Reporting Council
5th floor, 71-91 Aldwych
London WC2B 4HN

Dear Sirs

Consultation Paper – Proposals for Future Arrangements for Funding the FRC's Activities in Relation to Accounting, Auditing and Corporate Governance

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that in 2007 IMA members managed holdings amounting to 44% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the Financial Reporting Council (FRC) and its funding arrangements from the perspective of our members as institutional investors.

IMA is concerned that Government has decided to withdraw its contribution to the FRC's funding after 2008/09. The current funding arrangements were put in place in 2003 when Government accepted the recommendation from the independent Swift review that "the annual running costs of the independent regulator should be broadly shared by Government, business and the professional bodies¹".

We have seen little justification for the withdrawal - the cost saving of £3.5million is hardly significant for Government. As investors, we have an acute interest in ensuring the integrity of and confidence in financial reporting and corporate governance, and are the main group of stakeholders who support and enforce the Combined Code of Corporate Governance. In this respect, we believe Government

¹ Review of the regulatory regime of the accountancy profession – DTI, January 2003

should reconsider its decision - a Government contribution to funding means that the FRC is not just funded by those it regulates, gives weight to appropriate Government oversight of the FRC's activities and performance, and helps ensure the independence and effectiveness of the FRC as a regulator. In particular, the current credit market turbulence has posed one of the greatest risks to confidence in financial reporting and corporate governance for years. We believe Government should maintain its financial contribution and, therefore, its influence to help ensure the integrity of the system of financial reporting given its importance to the security of savings and pensions.

If the funding structure is to change, we believe it important that the issue is fully consulted on and we welcome the FRC's current consultation. We also welcome the FRC continuing to consult on the resources required each year on the basis of the risks to corporate reporting and governance and its proposed response². The FRC needs to be flexible in its planning and remain alert to developments that could necessitate changes to its priorities and planned activities. We set out in the attached our answers to the specific questions raised in the paper and set out below our main observations.

- The apportionment proposed means that the existing contributions from publicly traded companies and the accountancy bodies could increase by some 18 per cent from 2008/09. In part the level of discounts applied to other groups impacts this: AIM and PLUS companies' contributions are already discounted and it is proposed that the new groups, private companies and public sector organisations, will also be discounted by 50 per cent and 75 per cent respectively. In this respect, it is not clear how these discounts have been derived and certain of our members question their validity. We consider the FRC should have a more formulaic basis and publish how the discounts reflect the costs of the activities that do not apply to the groups concerned. As it stands the proposed discounts of 50 and 75 per cent seem excessive.
- Certain commentators have noted that increasing the amount of funding provided by the accountancy bodies could affect the FRC's objectivity in the future. Whilst we do not consider this has been an issue to date, the FRC should ensure that it remains open to measures that may not necessarily find favour with the audit practices, for example, certain of our members would like to see compulsory audit rotation, compulsory audit tendering and limiting a firm to auditing, say, 40 to 50 of the FTSE-500 companies being given more consideration.
- The FRC's budget for 2008/09 showed an increase of 9% in its core operating costs and 22% for actuarial operating costs. In considering whether the target level of its reserves should be increased to £2m over three years, it would be helpful if budget forecasts for the next two to three years were presented so that the impact of future cost trends and the proposed increase in reserves could be assessed for each group's contribution.

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Please do contact me if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours faithfully



Liz Murrall, Director – Corporate Governance and Reporting

IMA RESPONSE TO CONSULTATION - FINANCIAL REPORTING COUNCIL – PROPOSALS FOR FUTURE ARRANGEMENTS FOR FUNDING THE FRC'S ACTIVITIES IN RELATION TO ACCOUNTING, AUDITING AND CORPORATE GOVERNANCE

IMA's comments on the detailed questions raised in the consultation paper are set out below.

- 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 primary responsibility for implementing the standards we set or influence, monitor and enforce?***

IMA agrees that the FRC's costs should be met by the major groups of market participants which are subject to, or have regard to, the FRC's regulatory requirements, and have the primary responsibility for implementing the standards it sets or influences, monitors and enforces.

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

IMA agrees that the funding groups which prepare financial statements should contribute towards the UK's share of the IASB's costs. First, although only listed companies' consolidated accounts are required to be prepared under IFRS in that other entities can continue to prepare their accounts under UK GAAP, the IASB's work influences UK GAAP. Secondly, although not required, private companies and the parents of listed companies have the option of preparing their accounts under IFRS, and public sector organisations are moving to IFRS. Lastly, we do not believe that there is a case for two sets of accounting standards in the UK and in the medium term UK GAAP should be brought into line with IFRS to maintain the credibility of financial reporting.

- 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?***

IMA believes that the FRC has appropriately identified the two major groups which are subject to, or have regard to, its regulatory requirements but which do not contribute to costs.

- 4. Are there any other major groups of market participants which, in your view, should contribute to our funding arrangements?***

We do not believe there are necessarily other major groups of market participants which should contribute to the FRC's funding arrangements at this stage. That said, we consider the matter should be kept under review in that market structures can change.

- 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?

The apportionment proposed means that the existing contributions from publicly traded companies and the accountancy bodies could increase by some 18 per cent from 2008/09 (we understand their increase for 08/09 was already 10 per cent). In part the level of discounts applied to other groups impacts this: AIM and PLUS companies' contributions are already discounted and it is proposed that the new groups, private companies and public sector organisations, will also be discounted by 50 per cent and 75 per cent respectively. In this respect, it is not clear how these discounts have been derived and certain of our members question their validity. We consider the FRC should have a more formulaic basis and publish how the discounts reflect the costs of the activities that do not apply to the groups concerned. As it stands the proposed discounts of 50 and 75 per cent seem excessive.

Furthermore, certain commentators have noted that increasing the amount of funding provided by the audit practices could affect the FRC's objectivity in the future. Whilst we do not consider this has been an issue to date, the FRC should ensure it remains open to measures that may not necessarily find favour with the audit practices, for example, certain of our members would like to see compulsory audit rotation, compulsory audit tendering and limiting a firm to auditing, say, 40 to 50 of the FTSE-500 companies being given more consideration.

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

In principle, IMA agrees that it is appropriate for the FRC to increase the target level of its reserves to £2m. However, the FRC's budget for 2008/09 showed an increase of 9% in its core operating costs in relation to corporate governance, reporting and accounting to £11.9m compared to £10.9m in 2007/08. Furthermore, budgeted actuarial operating costs increased by 22% to £2.2m as compared to £1.8m. In view of these increases, it would be helpful if the FRC presented budget forecasts for the next two to three years so that the impact of future cost trends and the proposed increase in reserves could be assessed for each group's contribution.