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Dear Sir,

**PROPOSALS FOR FUTURE ARRANGEMENTS FOR FUNDING THE FRC'S  
ACTIVITIES IN RELATION TO ACCOUNTING, AUDITING AND  
CORPORATE GOVERNANCE**

Thank you for the opportunity to respond to your consultation paper. The London Stock Exchange supports the work of the FRC in its role as the UK's independent regulator for corporate governance and reporting. Answers to the consultation questions, based on feedback from our issuer and adviser community are provided in the attached appendix. Our more general comments are below.

We are concerned that the FRC's costs are increasing significantly. There was a 12% increase in the total business levy for 2008/9. This latest consultation paper suggests that the total business levy will increase by at least a further 18% as a result of the removal of the Government grant, including the effect of the proposals to replace that lost revenue. These are substantial increases, but there appears to be additional risk that the size of the business levy will increase by more than assumed in the consultation. In particular:

- There is no guarantee that additional funding will be forthcoming from the groups concerned, in which case the existing funding groups, which includes quoted companies, will shoulder an even greater burden than that projected in the consultation.
- The proposals appear to introduce inefficiency into the charging mechanism, which will result in increased FRC costs for administration. This inefficiency is particularly evident in the proposal to charge a 'new' funding group, namely public sector organisations; in reality a Government contribution to FRC costs by an indirect route.

- There is potential for an increase in the business levy to satisfy indirect, third party costs. In particular we note the recently published EFRAG paper<sup>1</sup>, which proposes enhanced funding at a national level to meet the costs for an expansion of their work. Such costs will increase the business levy.

The continual pressure to raise the business levy will encourage a regular re-examination of the levy's scope. This has a number of undesirable consequences not to mention adding complexity to the basis for charging and requiring considerable consultation effort.

Ultimately, regulatory costs borne by companies add to their overall cost of capital and for smaller companies in particular, such additional costs have a proportionally larger impact. The structure of the business levy already introduces an element of double-charging for companies, who are also subject to the levy indirectly as the accountancy profession passes on their costs through their audit and other fees. The proposal to widen the scope of the business levy to private subsidiaries of quoted companies compounds the potential for double and even triple-charging.

With regard to the points made above, there is a risk that the FRC will be leaving quoted companies with an impression that the business levy is subject to significant increases as a matter of course. Despite that risk, the consultation paper makes no reference to any cost-benefit analysis, or an attempt to identify potential cost savings.

Lastly, whilst the FRC's work is an essential part of the corporate governance framework, contributing to the global attractiveness of the UK's capital markets, the current approach to funding its work through the business levy is causing discontentment with the very community that its work benefits.

In conclusion, the FRC should now examine a wholesale reform of the business levy with the objective of creating a level playing field for charging, in particular removing the potential for issuers to be triple-charged. Given the extent of the historical increases in the business levy, we also request that an attempt to forecast future funding requirements (and the potential impact on the business levy) is included.

In addition to that work, and given the importance of the FRC's role in creating and maintaining an effective UK corporate governance regime, we request that the FRC applies additional lobby pressure to the Government to maintain their funding grant on the current basis beyond 2008/9.

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<sup>1</sup> <http://www.efrag.org/news/detail.asp?id=228>

We understand that the FRC is proposing to release a follow-up paper to this consultation and we look forward to the results of this analysis in that document.

Yours faithfully

A handwritten signature in black ink that reads "Andrew Wallace". The signature is written in a cursive style with a long horizontal stroke underneath the name.

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## APPENDIX

- 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?**

In light of the comments made earlier, we request that the FRC now investigates a wholesale reform of their approach to funding the business levy, with the objectives of creating a level playing field for charging, particularly removing the potential for issuers to be double or even triple-charged. That review should include a cost benefit analysis, examine the potential for cost savings and include an attempt to forecast future funding requirements and the consequent impact on the business levy.

In addition to that work, and given the importance of the FRC's role in creating and maintaining an effective UK corporate governance regime, we request confirmation that the FRC will be applying additional lobby pressure to the Government to maintain their funding grant on the current basis beyond 2008/9.

In relation to the proposals within this consultation, we request that the FRC provides more robust justification for the exclusion of other potential major funding groups, in particular larger charities.

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

Yes. However, this aspect should be considered as part of a wholesale reform of the FRC's approach to funding the business levy and our earlier comments refer.

- 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?**

We do not agree that sufficient consideration has been given to this issue and our earlier comments concerning the need to review the basis for applying the business levy and lobbying Government to maintain their contribution refer.

Specifically, the consultation proposes extending the business levy to large private companies, including the 'private subsidiaries of publicly traded

companies'. This proposal would result in a large element of double counting, since the levy for private companies would be based on turnover whilst for publicly traded companies the levy is based on market capitalisation, reflecting the value placed on the whole group.

Quoted companies are already exposed to an element of double-charging for the business levy, indirectly reflected in their accountancy and audit fees. The proposal to include private subsidiaries of publicly traded companies can only compound the potential for double-charging and even triple-charging. On this basis, large private subsidiaries of publicly traded companies already subject to the business levy should be excluded.

We request that the FRC provides more robust justification for excluding 'other potential major funding groups', particularly major UK charities. This should be in the context of a wholesale review of the basis for applying the business levy.

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

Our answers to questions 1 and 3 refer.

**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?**

We do not agree with this assessment. In particular, the FRC is proposing to apply a 75% discount to public sector organisations as part of their widened funding proposals. However, the consultation paper acknowledges that the FRC 'adds significant value for public sector organisations' and provides detail to support that claim. There is insufficient justification for affording such a large discount to this potential funding group, and this should be provided. Again, we believe that this aspect should be considered as part of a wholesale investigation into reforming the business levy and our earlier comments refer.

**6. Are there additional criteria which, in your view, we should take into account in determining the size of the contribution from these groups?**

At present, the FRC's core operating costs are met 35% each by public companies and accountancy professional bodies and 30% by Government grant. The proposals within the consultation suggest that the former should

contribute 42% each, with large private companies and public sector organisations contributing 11% and 5% respectively.

Given the comments above as to the size of the discount applied to public sector organisations in particular, further justification for the eventual funding split, particularly in reference to the low overall contribution made by public sector organisations, is requested. Once again, this issue should be considered within the context of a wholesale review of the approach to funding the business levy and our earlier comments refer.

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

The level of reserves should be supported by a 'reserves policy' and we look forward to clarification of that policy. We request that the issue of reserves should be examined as part of a wholesale review of the approach to funding the business levy, which should incorporate a cost-benefit analysis and a review of the potential for cost savings.