

**FINANCIAL REPORTING COUNCIL**

**CONSULTATION ON DRAFT PLAN AND BUDGET 2008 / 09**

**CBI RESPONSE**

**March 2008**

**I INTRODUCTION**

1. These comments are made first by reference to the main issues highlighted in the FRC Press Release, followed by further comments on the Draft Plan and Budget document itself, and the Supplementary Information document.
2. As noted below, there is a degree of complexity and quite a bit of duplication in publishing two documents, the Draft Plan and Budget itself and the secondary Supplemental Information document. Following the consultation, we suggest that the final Plan and Budget for 2008 / 09 is issued as one document, which we believe need not be any longer than the current draft of the main document. This will remove significant areas of duplication and be easier to digest.
3. We can broadly support much of the detail contained in the Draft Plan. On the proposed Budget, we note quite a significant increase is proposed to cover increasing responsibilities and additional staff resource. If resource issues have now been adequately addressed, we believe budgets for future years should more closely track inflation.
4. In Section V below, we suggest an additional item for the work programme. We recommend that the FRC undertakes an additional project to review and update the Guidance on Going Concern issued in 1994. This would be with a view to bringing UK best practice on the minimum period directors look forward in making their going concern assessment into line with current international accounting and auditing standards. We consider that this minimum period should be 12 months from the balance sheet date as permitted by such accounting and auditing standards, rather than 12 months from the date the directors approve and sign the accounts, which is currently provided by the 1994 Guidance.
5. We also note that the FRC is now consulting on the cost effectiveness of its regulatory approach, to which the CBI will be pleased to respond in due course.



## **II ISSUES MENTIONED IN FRC PRESS RELEASE**

### **Major activities for 2008 / 09**

6. The CBI supports the 4 main themes and major activities identified, namely :

- Promote FRC involvement in activities which help to develop confidence in corporate reporting and governance
- Monitor corporate reporting and governance practices in the UK and take enforcement action where appropriate
- Participate in development of high quality international standards and cooperate with international regulatory organisations
- Modify UK regulatory regime as appropriate to take account of EU and UK legislative changes

### **Major FRC Projects for 2008 / 09**

#### **1. Audit Choice - Implementation of Recommendations of FRC Market Participants Group**

7. We support this project and most of the Report's recommendations. The main one we did not support was that the report of the audit committee should be put to a shareholder vote.

#### **2. Review complexity and relevance of current reporting requirements**

8. This is a new project and will be of major interest to CBI members. Current reporting requirements stem from legislation, in particular the Companies Acts, accounting standards and the FSA Listing and Disclosure Rules.

9. We will be pleased to work closely with the FRC on this, and assess the scope for simplification and rationalisation for the benefit of shareholders, and possible cost savings for companies.

#### **3. Implementation of the Statutory Audit Directive (8<sup>th</sup> Directive) relating to foreign auditors**

10. This is mainly a regulatory matter for the FRC, but we will monitor developments on behalf of any CBI members affected, and comment as appropriate.

#### **4. Finalise the conceptual framework for actuarial standards**

11. We will monitor this, and take account of any input from CBI members affected.

### **Current Credit Market Conditions**

12. The FRC is clearly right to be seen to be on the front foot in assessing the impact of the credit markets on its activities and the role and responsibilities of its operating bodies.

13. The FRC issued a Press Statement on this in December, and we welcome the further useful statement on audit issues issued by the Auditing Practices Board in January.

### **Proposed Budget 2008 / 09**

14. We can support the proposed Budget.

15. We note there is an increase in staff costs of over £1 million due to a planned increase in headcount from 64 – 68 and increases in other salary costs.

16. We note this is quite a significant increase to cover increasing responsibilities and additional staff resource. If resource issues have now been adequately addressed, we believe budgets for future years should more closely track inflation.

17. We note that the FRC has issued a further consultation on its funding and levy proposals for 2008 /09 in February. We note that the proposed contribution towards the funding of the IASB of £700,000 is at the same level as in 2007/ 08, with an additional contribution of £100,000 towards the funding of EFRAG.

### **Rolling 3 year budget estimates**

18. In view of the Government announcement to withdraw its funding from April 2009, it might assist remaining stakeholders who bear these additional costs, if the FRC included a rolling 3 year budget forecast, so that stakeholders, when considering the formal budget proposals for the following financial year, could have an indication of cost trends and expectations based on estimates over a 3 year period.

19. This would help identify in particular any expectations for growth in the FRC workload, and in numbers of FRC staff to service that workload, which is a significant item in any budget.

### **Future funding of FRC**

20. We note the recent Government statement that it plans to cease to contribute to the funding of the FRC with effect from the financial year commencing April 2009.

21. The FRC will no doubt consult on proposals for filling this funding gap, but we wonder if the withdrawal of Government funding has any other implications for the relationship between the Government and the FRC. For example, we understand that the Government currently appoints the Chair and Deputy Chair of the FRC. Will this change once Government funding ceases ?

### **III FURTHER COMMENTS ARISING FROM THE DRAFT PLAN AND BUDGET DOCUMENT ITSELF**

#### **General Comment**

22. Whilst the FRC Press Release provides quite a succinct summary, the detail of the FRC's draft Plan and Budget for 2008 / 09 takes up two documents, and together seem unduly lengthy and repetitive, and probably would have been clearer if the two documents were reduced to one and some of the repetition avoided.

23. The approach of presenting the upsides and downsides to its activities and risk exposures in the Supporting Outcomes in the Supplementary Information document is supported, and that approach might also have been helpful in the section on strategic outcomes in the main doc, although the principal risks and potential downsides are generally noted in the text.

24. The major projects are noted in a separate section of the Draft Plan on Pages 17 – 21, which we support.

#### **Specific Comments**

25. As mentioned, we support the general approach of FRC setting out its objectives, strategic outcomes and risk exposures.

26. We support the broad thrust of Outcomes One to Six on Pages 12 – 16, subject to the following comments.

27. **On Outcome 3 (b)** on Page 13 on Auditing, we would suggest that there is no linkage between an efficient market for audit services and the way that audit work is undertaken.

28. **On Outcome Five (b)** on Page 15 regarding professionalism of accountants and actuaries, you could add "Guidance produced by the FRC on auditor liability limitation agreements may assist in the continuing stability of the audit profession."

#### **- Annex A - Strategic Framework**

##### **Strategic Outcome One – Corporate Governance – Page 28**

29. This and the Supporting Outcomes identified seem broadly ok. However the EU is increasingly intervening with prescriptive legal requirements (e.g 4<sup>th</sup> 8<sup>th</sup> and Transparency Directives), which should perhaps receive a mention.

##### **Strategic Outcome Two – Corporate Reporting – Page 29**

30. This and the Supporting Outcomes seem ok as far as they go, but they make no mention here of the proposed FRC project to review the information in accounts, and whether accounts can be made less complex and more useful to investors.

##### **Strategic Outcome Three - Auditing – Page 30**

31. Again seems ok as far as it goes, but there is no mention of the FRC project to provide guidance on auditor liability limitation agreements.

32. In respect of Implementation for Outcome 3 (a) (i) in respect of auditor liability limitation agreements, it could state : “Guidance produced by the FRC on auditor liability limitation agreements may assist in the continuing stability of the audit profession.”

#### **Strategic Outcome Four - Actuarial Practice - Page 31**

33. Seems ok.

#### **Strategic Outcome Five – Professionalism of accountants and actuaries - Page 32**

34. No mention here is made of the proposed changes to the Rules of the disciplinary scheme.

#### **Strategic Outcome Six – FRC Effectiveness - Page 33**

35. Seems ok.

### **IV COMMENTS ON SUPPLEMENTARY INFORMATION DOCUMENT**

36. This Document is in many respects more useful, because it seeks to set out the upsides and potential risks and downsides to the Strategic Outcomes, along with relevant major activities planned in the area in question.

37. In connection with **Strategic Outcome One (a)**, the CBI will be responding to the FRC consultation on changes to the Combined Code, which is also subject to some possible changes to the FSA Listing Rules, on which the FSA is also consulting.

38. In connection with **Supporting Outcome Two (b)**, on Page 13, perhaps there should be a specific reference to the Companies Act 2006, which provides a statutory requirement that accounts show a true and fair view.

39. In addition the Companies Act now sets down new statutory requirements for business reviews, which have taken effect for reporting periods commencing on or after 1 October 2007. On forward-looking information, which the FRC refers to in the penultimate paragraph on Page 13, the Act draws a distinction between quoted and unquoted companies, and only requires forward-looking information from quoted companies in their business reviews. The FRC and ASB should recognise this distinction in any pronouncements.

40. In connection with audit issues and **Supporting Outcomes 3**, there is no specific mention of auditor liability limitation agreements introduced by the Companies Act 2006, due to take effect in April 2008, and the subject of FRC draft Guidance currently out for consultation, to which the CBI will be responding.

41. However Supporting Outcome Three (a) third column on Page 15 does make a brief general mention of guidance in connection with the Companies Act impacting the performance of audits, but a bit more detail of guidance planned would be helpful.

## **V OTHER MATTERS**

### **Going Concern assessment**

42. We wish to suggest an additional item for the FRC Draft Plan in 2008. We recommend that the FRC undertakes an additional project to review and update the Guidance on Going Concern issued in 1994. This would be with a view to bringing UK best practice on the minimum period directors look forward in making their going concern assessment into line with current international accounting and auditing standards.

43. There is now a significant difference between the UK and elsewhere in the period that the going concern exercise looks at. UK best practice, as formulated in the document **Going Concern and Financial Reporting** published in 1994, (which was supported by the CBI at the time), is that the foreseeable future in assessing the going concern status, is **not less than 12 months from the date the directors approve the annual accounts**. This is also the position taken in the UK auditing standard on Going Concern - ISA (UK and Ireland) 570, which is the amended UK version of ISA 570 referred to below.

44. The 1994 Guidance was issued as a supplement to the first Cadbury Corporate Governance Code which, as in the current Code Para C.1.2, provided that boards should state that the company is a going concern with supporting assumptions or qualifications as necessary. A copy of the 1994 Guidance is attached.

45. However, international accounting standard IAS 1 (part of IFRS) and international auditing standard ISA 570 have set the period for the foreseeable future at **not less than 12 months from the balance sheet date**. This makes the UK out of line internationally.

46. CBI members consider that it would be appropriate for the FRC to review the Guidance published in 1994 with a view to bringing UK practice on the going concern period into line with international accounting and auditing standards at not less than 12 months from the balance sheet date. Using a period that starts and finishes later takes companies beyond the normal budgetary cycle, and places directors at significant more risk.

47. A further issue noted by CBI audit firm members is that auditing standard (SAS 130) which preceded ISA 570 introduced in 2004 provided more guidance and flexibility on how the auditor commented on going concern. Whilst it would be useful if this guidance was reinstated in ISA 570 when next reviewed, it might be possible to address this in the UK, in an updated version of the 1994 Guidance. In particular, auditors want to be able to say (if the circumstances warrant), that whilst they may have some concern over a company's going concern status, the accounts nevertheless show a true and fair view. In comparison ISA 570 makes a more stark choice for auditors in having to state either that they have no concerns about going concern, or that they have significant concerns, with no middle ground.

48. We will be pleased to discuss further with you.