



# The Consultative Committee of Accountancy Bodies

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The Institute of Chartered Accountants in England and Wales  
The Institute of Chartered Accountants of Scotland  
The Institute of Chartered Accountants in Ireland  
The Association of Chartered Certified Accountants  
The Chartered Institute of Management Accountants  
The Chartered Institute of Public Finance and Accountancy

Dear Stephen

## **DRAFT PLAN 2009/10, PROPOSED UPDATES TO THE STRATEGIC FRAMEWORK AND 2009/10 LEVY PROPOSALS, INCLUDING SUPPORTING INFORMATION**

On behalf of my CCAB colleagues, please find attached our detailed response to the above consultation. We welcome the opportunity to comment and are very supportive of the FRC's role in promoting confidence in corporate reporting and governance. We are committed to working with the FRC towards the achievement of proportionate and cost-effective regulation and oversight.

The main point we want to emphasise is that the Strategic Framework and Draft Plan for 2009/10 fail to fully recognise changed circumstances in the current economic downturn and these circumstances could be more fully explored in the risk assessment.

We suggest that the present economic circumstances warrant, in particular, a consultation on the Combined Code being issued in terms of its implementation within companies. This should cover areas such as the role of the non-executive director, investor guidance (currently largely covered by cross-reference to the Institutional Shareholder Committee statement of principles), frequency of review, remuneration committees and connections with ethics/'tone-at-the-top' and sustainability. We would support such a consultation happening as soon as possible, subject to the prior publication of the results of other reviews, such as those by the FSA and that chaired by Sir David Walker in order to benefit from their findings and ensure they are complementary.

We would also welcome the opportunity for the profession to engage the FRC more fully in certain aspects, in particular:

- the proposal to add 'related services' to Strategic Outcome Three (Auditing)
- how the profession will support the needs of SMEs in the light of the proposed micro-entity filing exemption adopted by the European Commission and
- the proposed review of the regulatory framework for professional discipline and enforcement of standards including the FRC's role within the framework.

We suggest that the FRC revisits its recent consultation on, and the responses to, its cost effectiveness from time to time and urge the FRC to consider our proposals for closer working with the profession, particularly in terms of the additional expertise and resource that we might be able to offer to the mutual benefit of both the FRC and the profession.

We have repeated our earlier suggestions that the role of the CCAB bodies in the context of the regulatory environment is more explicitly explained in the Framework (and similar documents) and that the CCAB bodies are named along with their status as Recognised Supervisory Bodies (RSBs) and Recognised Qualifying Bodies (RQBs).

Our last point relates to the budget for 2009/10. We feel that the FRC needs to more fully justify the proposed increase of 6.7% in core costs at a time when the profession and others feel that they should demonstrate restraint. The proposed increase is well in excess of the expected rise in the RPI and current pay settlements (being in the region of 2% or less) in the UK. We remain concerned about the implied extension of regulation that arises from the proposed budget increase and urge the FRC to adopt a greater focus on fewer areas, guarding against regulatory change where there is no proven need.

We look forward to discussing these issues in more detail and specifically ask that you respond to us on the areas for future collaborative working as identified in our detailed comments.

Yours sincerely

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# **CCAB RESPONSE TO THE CONSULTATION ON THE FRC'S DRAFT PLAN 2009/10, PROPOSED UPDATES TO THE STRATEGIC FRAMEWORK AND 2009/10 LEVY PROPOSALS, INCLUDING SUPPORTING INFORMATION**

## **GENERAL**

1. We repeat two points made in our response of 13 March 2008 to the FRC's consultation on its Draft Plan and Budget for 2008/09:

### ***Relationship with the Profession***

2. We believe that it would be helpful if early on in the Draft Plan and Strategic Framework clarity was provided with reference to the environment in which the FRC operates, including its interaction with the CCAB bodies who act as primary regulators of their members and firms under the oversight of the FRC. Separately, the FRC and the CCAB bodies have had discussions regarding this relationship and we feel there is recognition that it would also be helpful to identify where CCAB bodies, collectively or individually, may be involved in a task force or other type of group in order to drive a project forward.

### ***Professional Bodies subject to FRC Oversight***

3. There is a lack of definition in what is a publicly available document as to which bodies constitute the 'accountancy profession' and are subject to FRC oversight. We suggest that the CCAB bodies are named together with their status as RQB and RSBs as appropriate. This would facilitate their identification in Section D, the List of Abbreviations. We understand that for legal reasons it may be necessary to name organisations outside the CCAB which fall within the remit of the FRC even though they do not contribute to its funding.

### ***Cost Effectiveness and Opportunities for Joint Working***

4. Also, in 2008, the FRC consulted on its efficiency and cost effectiveness as a regulator. In its response the CCAB proposed that one of the ways in which the FRC could improve its efficiency would be through greater co-operation with or reliance upon the CCAB bodies where appropriate. We would cite the project on audit judgement and training as a good example of where one or more of the bodies has successfully undertaken a project under the auspices of the FRC. We are disappointed that the FRC's Feedback Statement on the Cost Effectiveness of FRC Regulation, published in December 2008, fails to respond to this proposal. We have therefore sought to identify further projects where a similar approach might be adopted as part of our response to this consultation; these are summarised in the attached Annex.

## **CONSULTATION QUESTIONS**

### **1) Do you agree with our proposed updates to our Strategic Framework?**

#### ***FRC Responsibility and Outcome 6 (Better Regulation)***

5. We support the second and third points identified on page 2 of the consultation document, namely the clarification provided about those areas the FRC is directly responsible for and those it is not and the update to Outcome Six to ensure that it fully reflects developments in the Better Regulation agenda.

#### ***"Related" Services***

6. We note the Strategic Framework includes a proposal to transfer references to "related" services to Strategic Outcome Three (Auditing), (previously subtitled as only "audit") from Strategic Outcome Five. We assume that the purpose of the change is to provide clarification as a response to external factors, such as the growth in audit exemption and developments in Europe. We would welcome further explanation of this change in the Framework in order to facilitate the public accountability of the FRC.

7. We believe that the time is right for the FRC to promote the experience in the UK and Ireland in the development of standards for related services. For instance in the UK and Ireland, the FRC has been in dialogue with CCAB bodies concerning the implementation of recommendations made in the *POB Review of How Accountants Support the Needs of Small and Medium-sized Companies and their Stakeholders*, including the use of a cross-profession report for non-audited accounts. We look forward to the increased presence of the FRC in the development of IAASB standards so as to promote the development of principles-based standards for related services that enhance user understanding of the degree of confidence in different types of reports. We therefore suggest that current developments at the IAASB in relation to revising standards for related services ought to be addressed under Supporting Outcome Three (b) (ii)
  8. The area of non-audit engagement standards is key for business and standard setters over the next few years, and it is important that good decisions are made early. As the world recession bites it provides new challenges and could highlight deficiencies in standards and practices that were untested in a boom period. As we understand that the micro-entity filing exemption is entering its parliamentary stage in Europe, we would welcome the opportunity to discuss how the accountancy profession will support the needs of SMEs in the future.
  9. The profession looks to the FRC for greater clarity in this area in terms of the definition of related services and what activities or projects it intends to cover in a national context, in particular if it intends to issue standards. With reference to this point, we note that the APB Scope and Authority of Pronouncements defines the scope of assurance services as ‘where they relate to activities that are reported in the public domain, and therefore within the “public interest.”’ There is a level of clarity over the investment circulars, which are both in the public domain and primarily relate to listing requirements for public interest entities. In contrast, compilation and reviews (other than interim financial information) are services provided in the deregulated market that may not be reported in the public domain. For related services more generally, therefore, the existing APB approach to scope may not be wholly applicable. We would look for clarification, therefore, as to how the FRC/APB defines ‘the public interest’ in relation to standards for related services.
  10. Related services are voluntarily commissioned and therefore do not fall within the responsibilities of either Government or the FRC. To date, the CCAB bodies have been working to maintain and enhance their quality by issuing technical guidance and monitoring practising firms. We would draw attention to the risk of over regulation in this area, as it may stifle market initiatives and be seen as inconsistent with the government policy to reduce the administrative burden.
- 2) **Do you agree that the major risks we have identified in the draft Plan 2009/10 are significant in relation to confidence in corporate reporting and governance in the UK? Are there major risks which we have not identified?**

#### *Current Economic Environment*

11. Whilst we agree with the major risks that have been identified, we have a sense that the Draft Plan fails to fully recognise the current economic environment. The markets have deteriorated further and rapidly since the publication of the report so the extent and impact of these risks may be more significant. There have also been alleged frauds including those of Madoff, Satyam and Stanford. In such a fast-moving environment it would be sensible if the FRC Board were to reassess the risks on a regular basis, possibly by way of updated risk assessments in the FRC’s quarterly strategic review. The response from the FRC ought to focus on risks including those arising from the current economic conditions.

#### *Carbon Emissions and Climate Change Disclosure*

12. We believe that the FRC and ASB should still respond appropriately to growing demands from financial statement users and politicians for corporate accounts to provide an enhanced level of disclosure with respect to carbon emissions and risks faced by reporting organisations in relation to climate change. The FRC and the ASB need to show leadership in issuing guidance as appropriate rather than leaving it to other (generally non-accounting) organisations such as the Climate Disclosure Standards Board, the Global Reporting Initiative and the Confederation of British Industry.

### ***Auditor Liability***

13. We are surprised that there are no references in the Framework and Draft Plan to auditor liability limitation agreements (LLAs). Whilst we accept that there are difficulties particularly in the US in accepting UK LLAs, the FRC did issue guidance in June 2008 and we expect to see some activity relating to implementation of this guidance in the FRC's Draft Plan.

### ***Oversight of the Professional Accountancy Bodies***

14. The major risks identified omit some relating to small practices – those on which small businesses will rely heavily. Under Strategic Outcome Five (Professionalism), there is no mention of the POB's role in respect of risk-based and cost effective oversight of the professional bodies. There is also a threat brought about by the lack of regulation of unqualified accountants (whose services may be used comparatively more widely in the current economic conditions). The transparency of regulation requires members of the public to better understand the scope of regulation, particularly while use of the term 'accountant' remains unrestricted.

### **3) Do you have any comments on the scope and relevance of the proposed major activities or projects which should be included in the Plan?**

### ***Government/FRC Responsibilities***

15. Whilst the updated Draft Strategic Framework splits the supporting outcomes between those for which government is responsible and those for which regulatory authorities are responsible, this results in a gap which may be bridged by emphasising the responsibility of regulatory authorities to influence government.

### ***POB's Oversight of the RSBs and RQBs***

16. Under Three (d) (iii) of section B, it is noted that the procedures of the RSBs for regulating their members sometimes require improvement in areas identified by POB. The work programme simply refers to POB's oversight of the RSBs and RQBs, without providing detail of its approach (which should be risk-based) and cost effectiveness.

### ***AIU Reports on Individual Firms***

17. The AIU now issues reports identified to individual audit firms. We suggest that research should be undertaken into the use made by those who employ auditors of the range of information now available (including, for example, transparency reports).

### ***FRC Thought Leadership***

18. We find it difficult to identify from the strategic framework how the FRC proposes to develop the intellectual knowledge base of 'financial reporting' in all its various aspects. Notwithstanding the need for the FRC to 'demonstrate an appropriate degree of independence from Government and the regulated communities', it is important for the FRC to demonstrate a clear interest in leading edge research and thought leadership, and to ensure that its pronouncements, and those of its various Boards, are sourced from the best evidence base available.

### ***FRC Effectiveness***

19. With regard to FRC effectiveness, there is a risk that certain (emerging) risks will not be foreseen within the Draft Plan for 2009/10. Indeed there are references to effectiveness throughout the Strategic Themes but these do not appear to have been carried through into the upside and downside risks identified in the Supporting Outcomes

### ***Regulatory Capital Requirements of IFRS***

20. Whilst it is more a regulatory issue than an accounting issue, the FRC needs to continue to engage more in the debate over the future interaction, if any, between regulatory capital requirements and IFRS and the associated risk of pro-cyclicality.

### ***The Combined Code***

21. There will be scope, in the near future, to open a consultation on the Combined Code and its implementation within companies covering areas such as the role of the non-executive director, investor guidance (currently largely covered by cross-reference to the Institutional Shareholder Committee statement of principles), frequency of review, remuneration committees and connections with ethics/'tone-at-the-top' and sustainability. However, the FRC should monitor the other consultations and reviews that are taking place, in particular the review by the FSA and that chaired by Sir David Walker. Any consultation on the Combined Code should await the publication of the results of these reviews in order to benefit from their findings and ensure they are complementary. There needs to be an appropriate balance between a principles-based Code which applies to all listed companies and the need for more prescriptive requirements for the regulated sectors - including the financial services sector.

### ***Complexity of Corporate Reports***

22. Under Strategic Outcome Two – Corporate Reporting, we agree that corporate reports are too complex and note that the FRC will be finalising its recommendations arising from its review. However, the potential impact, given that accounting standards are set internationally, is unclear. It may be that this is an area where one or more of the CCAB bodies can offer assistance to the FRC.

### ***AADB Review***

23. Under Strategic Outcome Five – Professionalism, the Plan anticipates a review of '... the regulatory framework for professional discipline and enforcement of standards including the FRC's role within the framework' as a major activity/project. The CCAB is supportive in principle. We hope that the FRC engages the accountancy profession in an open discussion in this regard and that it will provide more details as to the purpose, terms of reference and costs of such a review.

### ***Management Commentary***

24. The IASB is expected to release its 'Management Commentary' exposure draft in the next few months and the FRC will need to decide, at some point, whether to adopt it or continue with the extant UK Reporting Statement. There is no doubt that good narrative reporting is fundamental to improved transparency. The FRC and others should be promoting the effective use of narrative reporting as a communications exercise between companies and investors. The financial statements are increasingly complex and there is a need for management to express its view on the business model, the risks involved and its long-term sustainability

#### **4) Do you believe that there are any other significant risks which may emerge beyond the 2009/10 horizon, which may be relevant to our future planning?**

25. Government involvement in the banking sector, may present risks to corporate governance/reporting. Now that there are significant public monies invested in the banking sector, there is the concern that the Government could be tempted to support the introduction of further regulatory measures and/or standards.

#### **5) Do you have any comments on our draft budget for 2009/10?**

### ***Operating Boards***

26. It would always be useful to the accountancy bodies to see the full split of allocated budget between the Operating Boards; this would provide the transparency which in our opinion is necessary. In the CCAB letter of 13 March 2008 in response to the FRC's consultation on its 2008/9 Draft Plan and Budget, we suggested that steps should be taken to ensure that the list of activities/projects is reflected in the work plans of the Operating Boards. This does not seem to have been done.

### ***Budget Increase***

27. The Draft Budget for 2009/10 seems to be based on that for 2008/9 without any obvious zero base; the global increase of 6.7% in core costs seems to have simply been added without

justification or any reassessment of requirements. To increase the budget (and therefore the overall levy) by this

margin well in excess of the expected rise in the RPI, requires justification, in particular taking into account the tendency for pay settlements in the UK to be currently in the region of 2% or less. The professional bodies cannot raise significant extra sums from their members without that justification nor at this late stage must (The decisions be made on member subscription levels well ahead of the subscription year in question.)

### ***Implied Extension of Regulation***

28. We are also concerned about the implied extension of regulation that the budget increase suggests. Therefore, as set out in our letter of 13 March 2008, we urge the FRC to adopt a greater focus on fewer areas, guarding against regulatory change where there is no proven need.

## **6) Do you have any comments on our draft funding projection?**

### ***2009/10 Funding***

29. The 2009/10 funding position is contingent on the Government confirming its contribution. It would therefore seem appropriate for the FRC to identify the risk associated with this contribution not being available.

### ***Large Private Entities***

30. We note the extension of the FRC funding base to include large private entities, starting in 2009/10 with entities with a turnover of £1bn or more and expanding in 2010/11 to embrace large private entities with turnover of £500m or more. Such an explicit recognition of the crucial role played in the UK economy by large private sector enterprises underlines the importance of ensuring that the reporting, governance and assurance needs of such unlisted entities receive appropriate acknowledgement within the work programmes and project plans of the various FRC Boards.

### ***The Public Oversight System – Funding and Monitoring***

31. The change in funding resulting from the reduction of the Government contribution emphasises the importance of carefully balancing the regulatory needs in the UK against the imperative to do no more than necessary to meet EU-wide requirements (thereby avoiding ‘gold-plating’). In relation to the costs of the AIU and POB, the UK Government is required under EU law to comply so that ‘The system of public oversight shall be adequately funded. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms’ [Article 32(7) of SAD applies].

32. Furthermore, auditors and professional bodies experience problems in implementing, monitoring and demonstrating improvements in their processes when the monitoring cycles of the AIU and POB are so rapid in comparison to the necessary time required to implement improvements. Such monitoring processes do not provide an efficient mechanism for enhancing audit quality, particularly if monitoring is not risk-based and focused on systems employed by auditors and professional bodies.

33. The Commission Recommendation on external quality assurance (2008/362/EC) suggests that implementation of audit monitoring envisaged a less all-consuming process. Paragraph 20 suggests a period of up to 12 months between the issuance of the inspection report and taking action on the recommendations. Also, Article 43 of the Statutory Audit Directive refers to the frequency of inspections, stating that a quality assurance review for auditors of public interest entities should take place at least every three years.

**7) Do you have any comments on our proposed preparers' levy for 2009/10? Do you have any comments on our proposed insurance and pension levy rates for 2009/10?**

***Withdrawal of Government Contribution***

34. The FRC needs to justify more fully the increases in its projected budget at a time when the profession will find it harder to increase its contributions, especially as the government intends withdrawing its contribution.

***The FRC's Future Funding Model***

35. As stated in our response of September 2008 to the FRC's consultation on its future funding arrangements, we continue to believe that there is a strong case for the public sector to continue to make a contribution to FRC funding insofar as its role addresses international accounting and auditing standards. All public sector organisations are currently scheduled to be reporting on an IFRS basis by 2010/11. Also, we do not accept the reasoning behind the large discounts which apply to both large private companies and public sector organisations.

**OTHER COMMENTS**

36. Broadly, we are supportive of the way in which the draft Plan considers the environment in which the FRC operates, the major risks facing the accountancy and actuarial professions, and the activities and projects necessary to address those risks. The consideration of those risks in the draft risk assessment beyond the one year period formally covered by the document is welcome. Nevertheless, it is difficult for the reader to understand the FRC's process of identifying the major risks and the activities and projects necessary to address them. In reviewing the document, it is easy to lose the logical flow from one section to another. An overview of the Plan would explain how the different sections relate to each other.

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**Possible Areas for Better Working together between the FRC and the CCAB:**

*AIU reports identified on individual audit firms* - research into the use made by those who employ auditors of the range of information now available (including, for example, transparency reports).

*Corporate Reports* – these are too complex; it may be that this is an area where one or more of the CCAB bodies can offer assistance to the FRC.

*POB inspection visits* – POB have indicated that they will review arrangements with the RSBs and RQBs to reduce the regulatory burden by introducing more efficient and simple working practices and removing duplicate effort.

*AIU and RSB inspections* – currently completely separate, again there is a need to review to remove duplicate effort and reduce the regulatory burden.

*Remit and Responsibilities of the FRC and its Boards vis-à-vis the CCAB Bodies* possibly by way of some written protocols.

More generally, thought leadership initiatives, specialist projects, (e.g. the project on audit firm governance, the financial reporting supply chain and the role of professional accountants in business).