



## **Summary of feedback on the Draft Plan & Budget 2008/09 and the FRC Response**

### **Introduction**

This report summarises the feedback received, and our response, relating to:

- our approach to setting our priorities
- the major risks we have identified to the achievement of our overall Aim and the outcomes defined in our Strategic Framework
- the major activities and projects we are proposing to implement in 2008/09 to mitigate those risks
- our assessment of the major residual risks
- our funding and expenditure for 2008/09.

We received fourteen responses to our Draft Plan & Budget 2008/09:

- Four responses from business organisations
  - CBI
  - Hundred Group of Finance Directors
  - London Investment Banking Association
  - Quoted Companies Alliance
- Two responses from investor organisations
  - Association of British Insurers
  - Investment Managers' Association
- Eight responses from the accountancy professional bodies and audit and advisory firms:
  - Association of Practicing Accountants
  - Consultative Committee of Accountancy Bodies
  - London Society of Chartered Accountants
  - Deloitte & Touche LLP
  - Ernst & Young
  - Grant Thornton UK LLP
  - KPMG LLP
  - PricewaterhouseCoopers LLP



## **Feedback on our approach to explaining our priorities**

The following section summarises the feedback on our approach to setting our priorities, and our response.

### *Feedback received*

Twelve respondents commented on our approach to explaining our priorities.

Two respondents welcomed the approach without further comment.

Eight respondents welcomed the degree of transparency provided by the approach, but commented on the length and detail included in the documents. It was noted that there was a degree of duplication between the two documents and that it would be easier to digest if the final Plan & Budget was issued as one document. They also provided a number of constructive suggestions for streamlining and introducing additional clarity in the presentation of future Plans.

Two respondents commented that the new approach was over-complex without making any suggestions as to how to simplify the approach.

### *FRC response*

In response to the feedback received, we have published this finalised Plan & Budget 2008/09 as a single document.

In developing our future annual Plans, we will consider carefully how to maintain the degree of transparency welcomed by the majority of respondents while addressing the concerns about the complexity of the presentation of the 2008/09 Plan.

## **Feedback on our assessment of risks and proposed Plan**

The following section summarises the feedback, and our response, in relation to:

- our assessment of the achievement of the outcomes defined in the Strategic Framework
- the scope and relevance of our major activities and projects
- our assessments of residual risks.

We have summarised the feedback and our response in relation to our Overall Aim and the six Strategic Outcomes.



## Overall Aim – Confidence in corporate reporting and governance

### *Our assessment of the achievement of the Outcome and major risks*

No respondents disagreed with our overall assessment that “our Aim is *largely achieved* at present but there is no room for complacency”. Three respondents specifically endorsed our assessment.

Two respondents specifically endorsed our overall assessment of the risks to the achievement of the outcomes in the Strategic Framework; other respondents commented on risks in relation to specific Strategic Outcomes.

### *Our major activities and projects*

Three respondents specifically supported the overall direction of the proposed Plan.

Five respondents commented on the need, identified in the draft Plan, to take into account, in an appropriate way, the implications of the credit market conditions.

One respondent commented that the FRC needed to adopt a greater focus on fewer areas, but neither they nor any other respondent identified activities or projects which should be removed from the Plan.

### *Our assessment of the residual risks*

No respondents commented on any major residual risks other than the risk identified in relation to an efficient market for audit services in the UK which we comment on under Outcome Three below.

### *FRC response*

We have not changed our broadly positive assessment of the present achievement of our Overall Aim, but will continue to keep under review the issues associated with the credit market conditions.

## Outcome One – Corporate governance

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is largely achieved at present.

However, one respondent suggested the continuing effectiveness of the “comply or explain” approach is *unlikely to be achieved* if the trend towards improved disclosures of corporate information does not continue rather than there merely being ‘*significant concerns*’. Two respondents emphasised the risk to



the continuing effectiveness of the “comply or explain approach” if investors pursue a “box-ticking” approach to the application of the Combined Code. One respondent emphasised the potential impact of regulatory requirements arising from EU legislation.

### ***Our major activities and projects***

One respondent suggested that the FRC should do more to encourage the professional development of audit committee members.

Two respondents commented on the need to balance the level of disclosure required in relation to corporate governance with the need to encourage people to serve on boards.

One respondent emphasised the importance of our proposed project to update the current guidance on Going Concern.

### ***Our assessment of the residual risk***

No respondent commented on the residual risks in relation to corporate governance.

### ***FRC response***

We have not changed our broadly positive assessment of the achievement of the Strategic Outcome and Supporting Outcomes in relation to Corporate Governance. We note the concerns expressed in relation to the downside risk if the trend towards improved disclosures does not continue, or if inappropriate disclosure requirements discourage skilled and experienced people from serving on boards; we will keep our current assessment under careful review.

We remain strongly committed to the effective operation of the “comply or explain” approach and will have careful regard to the comments that have been made in relation to the present regime in our work on corporate governance in 2008/09, including the need to continue to influence relevant EU (and UK) legislation.

We believe that it would not be appropriate for the FRC to undertake work in relation to the professional development of audit committee members. This matter is already covered by the provisions of the Combined Code and is primarily for market participants to address.



## Outcome Two – Corporate reporting

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is *largely achieved* at present, although respondents noted the risks we identified to its continuing achievement.

### *Our major activities and projects*

Eight respondents expressed support for our proposed project to consider the complexity and relevance of corporate reporting. One of these respondents emphasised the importance of adequately defining the scope of the project. One further respondent emphasised the necessarily long-term nature of the project and the need to involve the international standard-setters.

Respondents also commented on the importance of influencing US acceptance of IFRS, progress at the appropriate pace towards convergence between UK GAAP and IFRS, the need to continue to influence EU adoption of IFRS, maintaining adequate guidance on narrative reporting, and the FRC's role in relation to the public sector.

### *Our assessment of the residual risks*

No respondents commented on residual risks in relation to corporate reporting.

### *FRC response*

We have not changed our broad assessment of the achievement of the Strategic Outcome and Supporting Outcomes in relation to Corporate Reporting.

The feedback we have received will, however, be of value to us in implementing our project to consider the complexity and relevance of corporate reporting (including the specific offers of help with the project). We will take careful note of the other comments in our work on corporate reporting in 2008/09.



## Outcome Three – Auditing

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is *largely achieved* at present, although respondents noted the risks we identified to its continuing achievement.

The majority of comments in relation to auditing focused on those aspects of the Plan relating to the current high level of concentration in the audit market and the recommendations of the Market Participants Group (MPG).

Seven respondents agreed with the emphasis which the FRC had given to the risks associated with this degree of market concentration, and commented on specific aspects of the FRC's proposed response. Three respondents questioned the extent to which the market concentration represented a risk to confidence. One respondent commented on the long term nature of any work to influence the degree of concentration in the audit market and the need to consider whether this would represent an effective use of FRC resources. One respondent noted the FRC's lead role in implementing a number of the MPG recommendations.

One respondent commented that highlighting a risk that auditors might fail to address the risks arising from current credit market conditions might undermine confidence in the auditing profession.

One respondent suggested that the downside risk included in the Plan relating to the recruitment and retention of high quality audit staff should be identified as an FRC priority. One other respondent noted this risk.

### *Our major activities and projects*

Four respondents commented on the importance of appropriately influencing the development of international auditing standards and the merits of making progress in implementing the revised standards.

Two respondents suggested that the APB Ethical Standards should be aligned with or replaced by the IFAC Code of Ethics.

One respondent emphasised the merits of Auditors Liability Limitation Agreements; another respondent noted the importance of demonstrable widespread and public shareholder support if boards were to be asked to agree to any changes relating to such agreements.

Two respondents questioned the planned embedding of the APB Promoting Audit Quality framework within the AIU's system for reviewing and reporting on audit quality.



One respondent proposed that we should include a project in the Plan in relation to guidance on the third country auditor regime. The same respondent asked us to influence government guidance in relation to criminal sanctions against auditors.

### *Our assessment of the residual risks*

No respondents commented on any major residual risks in relation to auditing other than in relation to an efficient UK audit market, which two respondents specifically noted as a major residual risk.

### *FRC response*

We have not changed our broad assessment of the achievement of the Strategic Outcome and Supporting Outcomes in relation to auditing.

In particular, while noting the range of views that have been expressed, we remain of the view that the implementation of the recommendations of the Market Participants Group (MPG) in relation to competition and choice in the audit market is an appropriate market-led response to the risks arising from the current characteristics of the audit market. We will monitor and implement, where appropriate, the recommendations of the MPG.

We disagree with the suggestion that it is not appropriate for us to highlight the risks for auditors arising from credit markets conditions. We have received positive feedback on the usefulness of our December 2007 statement highlighting these risks.

We will continue to contribute to the IESBA's project to revise and clarify the IFAC Code of Ethics but we do not agree that we should replace our ethical standards with the IFAC Code. The IFAC Code is still being finalised and is not due to be implemented substantially for a number of years. We believe that the ethical standards which the APB issued in 2004 remain effective and appropriate.

We consulted on guidance on Auditor Liability Limitation Agreements during 2007/08 and have included a project in 2008/09 to take appropriate action in the light of the outcome of the consultation.

We have identified as a major risk the consequences of a failure to recruit, develop and retain sufficient numbers of high quality audit staff in our Strategic Framework; however we have explained that we regard this as an issue primarily for the accountancy profession and audit firms to address.

We consulted extensively on our published Framework for Audit Quality and will keep it under review. We are responsible for determining the AIU's operational approach and we believe that it is appropriate for the AIU to have regard to the Framework in its monitoring activity.

The Plan includes a project relating to the implementation of the third country auditor regime; we will ensure that guidance is provided as appropriate.



The Plan also includes a project to develop guidance, as necessary, in relation to changes in the Companies Acts impacting the performance of audits. However, it is not within our remit to develop guidance relating to criminal sanctions against auditors, which is a matter for BERR.

## Outcome Four – Actuarial practice

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is not *largely achieved* at present or with our assessment of the downside risks.

### *Our major activities and projects*

Two respondents supported our proposed activities and projects in relation to actuarial practice in general terms. Two respondents emphasised the importance of progress in developing BAS standards.

### *Our assessment of the residual risks*

No respondents commented on residual risks in relation to actuarial practice.

### *FRC response*

We have not, at this stage, changed our broad assessment of the achievement of the Strategic Outcome and Supporting Outcomes in relation to actuarial practice.

However, since the publication of the Draft Plan & Budget 2008/09 in January 2008, we have made significant progress in the formal implementation of the Conceptual Framework for actuarial technical standards, with the publication of an Exposure Draft in March 2008 covering the Conceptual Framework itself and the Scope & Authority of the BAS.

With the process of establishing the Conceptual Framework now well advanced, the BAS has begun to focus on the implementation of the new book of Standards.

A Discussion Paper on Actuarial Mortality Assumptions was published in March 2008. Two further important papers were published in April 2008: an Exposure Draft of a Reporting Standard, and a Consultation Paper on the Structure of the new BAS Standards. This second document broadly defines the work that the BAS expects to carry out over the next two to three years, including how the adopted Guidance Notes will be absorbed into the new BAS Standards.

We will make recommendations to the Actuarial Profession on the arrangements for the monitoring and scrutiny of actuarial information to ensure that it complies with the relevant actuarial standards. We have upgraded this project to a major project in the Plan for 2008/09.



## Outcome Five – Professionalism of accountants and actuaries

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is *largely achieved* at present

One respondent suggested that we should identify the individual professional bodies whose regulatory activities are subject to oversight by the FRC, including the RSBs and RQB.

One respondent questioned whether there is a plausible risk that the accountancy professional bodies will not adequately address issues relating to the professionalism of their members.

### *Our major activities and projects*

One respondent suggested that FRC regulatory reviews should give prominence to examples of best practice as well as areas for improvement.

### *Our assessment of the residual risks*

No respondents commented on residual risks in relation to professionalism of accountants and actuaries.

### *Proposed response*

We have not changed our broad assessment of the achievement of the Strategic Outcome and Supporting Outcomes in relation to the professionalism of accountants and actuaries.

In response to the question about the risk that the accountancy professional will not adequately address the relevant issues, we consider that we have properly identified areas for improvement in the regulatory activities of the accountancy professional bodies and, while these do not indicate fundamental shortcomings, we believe that these areas should be addressed.

We have not given additional detail to the individual professional bodies whose regulator activities are subject to oversight by the FRC in this Plan, our risk assessments and work programme apply to all the relevant bodies.

We will take account of respondents' comments in implementing our 2008/09 Plan.



## Outcome Six – FRC Effectiveness

### *Our assessment of the achievement of the Outcome and major risks*

No respondent disagreed with our assessment that this Outcome is *largely achieved* at present. Two respondents emphasised the importance of the FRC's role in promoting confidence in corporate reporting and governance in the UK.

One respondent commented on the need for the FRC to consider the possible implications for its effectiveness of a major corporate failure.

### *Our major activities and projects*

One respondent commented that the Plan did not adequately address the impact of FRC regulation on SMEs, but noted the current consultation on regulatory cost-effectiveness. One respondent asked us to consider the overall impact of FRC regulation, including on SMEs.

Two respondents suggested revisions to specific outcomes included in the Strategic Framework.

Two respondents commented that it would be helpful to include more information on the FRC's international activities. One respondent supported the FRC's engagement with IFIAR, but noted the importance of a proper assessment of IFIAR's costs and benefits.

Three respondents suggested that more detail should be provided about projects: the objectives, outputs and timings of consultations are referred to.

Two respondents suggested that it would be useful to distinguish between business-as-usual activities and new projects or activities.

Four respondents noted that in light of the Government withdrawal of funding, mechanisms should be put in place to provide assurances regarding the value, efficiency and effectiveness of FRC activities.

Three respondents suggested that the FRC should publish two or three-year rolling budget estimates.

One respondent suggested that the FRC should invite the NAO to carry out periodic financial assessments.



### *Proposed response*

We have not changed our overall assessment that this Outcome is *largely achieved* at present but we have taken careful note of the comments made in relation to the risks to our own effectiveness.

Specifically in response to the feedback, we have updated the Plan as follows:

- we have included an additional project to review and, if necessary, refresh the Strategic Framework (with the intention that we will consult on any proposed changes when we consult on the 2009/10 Plan)
- we have included an additional major activity to complete a consultation regarding future funding of the FRC's core operating costs in relation to accounting, auditing and corporate governance.

We will update our arrangements for providing regular summaries of FRC consultations.

We are consulting on our revised funding arrangements following the discontinuation of the present arrangements for the Government contribution to our costs. We are committed to consulting in a timely way on our annual budget and will maintain our commitment to operating efficiently with adequate resources and management resources, including managing our costs effectively.

We will consider the proposal to provide forward budgetary estimates in the context of our Plan for 2009/10. 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 agree that there is merit in providing stakeholders with a longer term view of our likely funding requirements.

We have not attempted to distinguish between "business-as-usual" and new activities and projects. All the activities and projects included in the Plan are based on our risk assessments and our responsibilities. We make clear in the Plan that the key themes of our work in 2008/09 represent a continuation of those we pursued in 2007/08.

We do not consider that inviting the NAO to review our financial effectiveness would be appropriate as the FRC Board has primary responsibility for monitoring our activities. We also believe there could be a conflict of interest given our oversight activities in relation to the NAO and the other national audit agencies. We have in place extensive consultation arrangements with our stakeholders and are committed to meeting the Principles of Good Regulation.



## **Responses to our funding and expenditure for 2008/09**

This section summarises the feedback in relation to our draft budget proposals for 2008/09.

### ***Feedback received***

Two respondents, representing the business community, supported the proposed budget.

Five respondents, representing the accountancy profession and major accountancy firms, questioned the justification for the increase in the FRC's budget and suggested the need for a fuller explanation of the proposed increase. Three of these respondents felt that the proposed increases were excessive. One respondent commented specifically in relation to the increase for the AIU.

One respondent expressed support for the increase in the FRC budget in relation to actuarial standards and regulation.

### ***Proposed response***

In response to the feedback we have received on our draft budget, we have provided a fuller explanation for the increase in budget.

Additional responsibilities have resulted in upward pressure in our costs and we believe the overall direct cost of FRC remains relatively modest. In relation to our core operating costs, therefore, we do not propose any changes in aggregate to the draft Budget.

We have reviewed the allowance for contingencies included in the budget for the AIU and have been able to reduce the budget from the proposed £2.7m to £2.5m without any change to our planned programme of audit inspections.