

Policy and Planning Manager
For the attention of : Sir Christopher Hogg and Mr Paul Boyle
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By post and by email

28 May 2008

Dear Sir

Cost-effectiveness of FRC regulation

We write in response to the invitation to comment on the Discussion Paper “Cost-effectiveness of FRC regulation” issued by the Financial Reporting Council in March 2008.

We fully support the FRC’s aim to promote confidence in corporate reporting and governance. It is important that the costs associated with regulation are balanced with their benefits. We are pleased to note that the FRC and its constituent bodies have done some good work in recent years to increase the effectiveness of regulation. This includes the work on promoting audit quality and improving choice in the UK audit market.

We believe this particular consultation exercise provides an opportunity for the FRC, the accountancy profession and the business community to work together to make a significant step forward in initiating, developing and implementing regulation in an effective and cost efficient manner. This consultation process is timely. The current economic conditions are forcing all entities to consider their cost bases and to eliminate unnecessary expense. Annex B to the Discussion Paper illustrates the extent of the costs associated with corporate reporting and governance. These costs account for a significant part of the UK economy and it is critical that these are reviewed on a regular basis.

We set out our principal recommendations in response to the Discussion Paper below, followed by other matters which are relevant to this consultation process. These are in the form of actions which we recommend the FRC and its constituent bodies take to improve the cost-effectiveness of regulation.

Principal recommended actions**1. Increase collaboration with international bodies and take decisive actions to harmonise UK accounting, auditing and ethical standards with global standards.**

We urge the FRC and its constituent bodies to increase collaboration with international bodies including the IASB, IAASB and IESBA and to make this central to the strategy. The FRC should seek to ensure that the quality of international standards is enhanced.

There is a need to recognise that the UK is not seen as competitive as it once was. Taking actions such as those listed below will seek to mitigate the risk that organisations will regard the UK as a difficult place to conduct business and relocate their headquarters or operating activities elsewhere.

a) Embrace a principles based approach to regulation

We welcome the FRC's support for a "principles based" approach to standard setting. Such an approach has received support from many bodies around the world. What is needed now is leadership on putting principles-based regulation into operation. The UK is in an excellent position to assume a leadership role. The Financial Services Authority is playing its part in this area. We believe that the UK accountancy profession, together with the FRC, should be working more explicitly to put principles into practice.

b) Remove ISA "Plus" requirements

The APB should adopt International Standards on Auditing (ISAs) and as far as possible remove the requirement for UK auditors to comply with the additional "plus" requirements. An example of the ineffectiveness of the current situation is that there is currently an inconsistency in the period which the directors and auditors must consider when assessing whether the company is a going concern, between ISA 570 "Going concern" and IAS 1 "Presentation of financial statements".

c) Adopt the clarified IFAC Code of Ethics

We strongly encourage the FRC to prepare to adopt the forthcoming clarified IFAC Code of Ethics for periods commencing on or after 15 December 2009.

d) Implement international auditing and accounting standards without embellishment

We urge the FRC to avoid "gold-plating" or "tinkering" with international standards for use in the UK unless legally required to do so. These minor changes serve only to increase the complexity of regulation, with little or no benefit to the users.

- e) Remove old standards and guidance

We recommend that the FRC undertakes an exercise to remove old standards and guidance that are no longer relevant. UITF 21 “Accounting issues arising from the proposed introduction of the euro” is an example of an extant document which now serves little purpose.

2. Improve the process for issuing standards and other regulations to enable them to be implemented in a controlled and effective manner. Influence actively other standard setting bodies and regulators to do the same.

We strongly recommend that the FRC and its constituent bodies should introduce new or changed regulations on a systematic and well planned basis. At present there appears to be little central coordination. There are a plethora of dates to remember and on occasion a lack of advance notice of the new rules, so that the introduction of the change cannot be planned in an orderly and secure manner. Over the last reporting season, there have been key dates to remember such as:

- 20 May 2006;
- 1 November 2006;
- 1 January 2007;
- 20 January 2007;
- 6 April 2007; and
- 1 October 2007.

These dates cover only some changes in content of annual reports. They exclude dates arising from any new auditing or ethical requirements.

In our opinion, the use of multiple dates adds to the costs of change and jeopardises their implementation. Organisations wish to plan properly for changes, to consider carefully the new rules, to update as necessary their systems and to train their staff.

We therefore ask the FRC to ensure it and its constituent bodies adopt practical measures to:

- a) simplify the implementation process by having one agreed implementation date for new rules on accounting, auditing, corporate governance and other matters each year (e.g. periods commencing on or after 1 November);
- b) issue standards and guidance well in advance of the effective date with a minimum of six months and preferably 18 months in advance; and
- c) seek to influence other regulators in the corporate reporting area to use the same effective date.

3. Give small and medium sized entities (SMEs) a voice in FRC matters

Appendix B of the Discussion Paper illustrates that over 50% of the costs of preparing statutory accounts are incurred by entities which are below the statutory audit threshold

and over 50% of audit costs are incurred by privately owned companies and charities. Section three of the Paper refers to the contribution of the ASB's and APB's committees on smaller entities. In our experience, these groups do not have sufficient standing to make their views heard. For example, if CASE disagrees with the ASB, it does not have the right to say so publicly. Its right is merely to report to its parent body, the ASB, on which small business is not obviously represented. The Paper refers to the major simplification of FRS20 in the FRSSE. This was not what the ASB issued for comment in its Exposure Draft or indeed was its preference in the latter stages of finalising that edition of the FRSSE. It was a last minute amendment to the document and CASE's views were never publicly heard.

We believe that the FRC should establish a SME Panel to give smaller entities a voice and an opportunity to challenge the ASB and the APB. For example, we believe that the FRSSE should be revisited, once the ASB has finalised its plans for convergence with IFRS, to see how the reporting burden on smaller entities may be reduced.

To improve the cost effectiveness of audits for SMEs, we recommend that such a Panel should challenge the APB to make the following changes.

a) Issue a control framework suitable for SMEs

The control framework in ISA 315 (UK & Ireland) is designed for large entities. The APB should work with the IAASB to develop a control framework which is suitable for smaller entities which would identify the key controls which these entities should implement. This would also improve the quality of reporting to those charged with governance.

b) Develop "principles-based" auditing standards to reduce the current box-ticking approach

We welcome the issue of Practice Note 26 "Guidance on smaller entity audit documentation". However, we urge the APB to take further action to reduce the costs incurred in the audit of SMEs. This could be achieved by supporting the development of "principles-based" auditing standards and developing more "principles-based" guidance which would reduce the current box-ticking approach. Audit practitioners would then spend less time behind their computer screens and more time in the business and providing value-added advice to those charged with governance.

Other recommended actions

1. Improve communication in corporate reporting by reducing complexity

Due to the increasing number of accounting standards and disclosures required in directors' report and corporate governance statements, the length and complexity of annual reports has increased significantly over the last ten years. In the 2007 Deloitte annual survey on narrative reporting, we identified that the average number of pages in annual reports almost doubled from 45 pages in 1996 to 89 pages in 2007. We are pleased to see that the FRC has commenced recently a project to review the complexity

and relevance of current corporate reporting requirements. The FRC should publish a clear set of objectives and targets for the working party to ensure it is effective.

2. Increase the openness and transparency of the operations of the FRC and its constituent bodies

We encourage the FRC to take the following practical steps to encourage greater openness and transparency:

- a) make available on line full agendas for meetings of the FRC Board and all the constituent bodies;
- b) publish detailed minutes for the public within a reasonable timescale; and
- c) provide on line responses to consultations within seven days of the end of the consultation period.

The provision of agenda and minutes of meetings would enable market participants to be aware of policy decisions and to plan ahead for future changes. This would allow for better workload management by those required to implement new rules. We acknowledge that exceptions will have to be made, on grounds of confidentiality, in respect of matters discussed by the Financial Reporting Review Panel (FRRP) and Accountancy and Actuarial Discipline Board (AADB).

3. Embed cost/ benefit analysis into the FRC's project planning

At the outset of any project the FRC bodies should consider what the business case is for undertaking the exercise. The cost/benefit analysis of each project should be assessed before the project commences. An essential part of this process would be to engage in active consultation with market participants on whether change is needed. Assessing the benefit of maintaining existing standards would be an important part of this process. Consideration should be given to the grouping of projects to avoid piecemeal change which serve to undermine confidence in corporate reporting and governance.

4. Cease normal inspection activities during the busy season and provide informal feedback so that remediation can take place on a timely basis.

Overall, we are supportive of the AIU's inspection activities and its role in helping to promote confidence in corporate reporting and the work performed by audit firms. To enable firms to manage inspections and respond to any matters raised effectively, we encourage the FRC to adopt the following practical measures:

- a) cease normal inspection activities during the "busy season"; and
- b) provide interim comments informally before the 15 December (i.e. before the "busy season" commences) to enable remediation to take place on a timely basis.

5. Seek to avoid any unintended consequences of the change introduced by the Companies Act 2006 regarding the requirement to maintain “adequate” accounting records

We have, perhaps unfounded, concerns about the implications of the apparently modest change introduced by the Companies Act 2006 regarding the adequacy of accounting records. We understand that the FRC is awaiting Counsel’s opinion on the interpretation of “adequate accounting records” but very little detail has been made available to date. Depending on the content of the Counsel’s opinion this requirement could have a significant impact on the work undertaken on accounting records. We urge the FRC to consider unintended consequences very carefully prior to the publication of guidance in this area and to undertake a wider consultation if the Counsel’s view is that the new wording in the Act represents a significant change.

6. Promote cost/ benefit analysis in the regulation of the actuarial profession

The FRC and POB published two major discussion papers (together running to over 150 pages) on actuarial practice and regulation on 23 May 2008, some time after the publication of the Discussion Paper “Cost-effectiveness of FRC regulation”. The discussion paper "Monitoring and Scrutiny of Actuarial Work" refers to a test for effectiveness of a regulatory measure, though there is little reference in the document as to how this will be measured. We have seen reference in other documents issued by the FRC to the size of liabilities measured and/or reported upon by actuaries to justify regulation, but the relatively small size of the actuarial profession must also be a factor. The cost-effectiveness and potential regulatory burden of standards for the actuarial profession should be addressed rigorously.

We recommend that the review of the cost-effectiveness of regulation should be repeated in five years’ time.

Martyn Jones and Isobel Sharp would be pleased to meet with you to discuss in more detail our comments.

Yours faithfully

Deloitte & Touche LLP