



FINANCIAL REPORTING COUNCIL

**COST-EFFECTIVENESS OF FRC REGULATION:
FEEDBACK STATEMENT**

DECEMBER 2008

One – Introduction

This paper summarises the responses to our discussion paper “Cost-effectiveness of FRC Regulation”, which we published in March 2008, and gives our feedback. The discussion paper highlighted the range of actions the FRC has taken over the past few years to reduce the costs to market participants of the regulation for which we are responsible. It invited stakeholders to comment on further opportunities to reduce regulatory costs whilst preserving confidence in corporate reporting and governance. The main focus of the discussion paper was on opportunities to reduce the costs associated with FRC regulation rather than on our internal costs.

The responses we received were challenging but constructive and we are grateful to all those who commented. We received nine responses, which are listed in Annex A and are available on the FRC website at <http://www.frc.org.uk/about/feedback2008.cfm>.

This paper summarises the responses we received, and our feedback, on:

- I) our overall approach to good regulation, which we believe is essential to the cost-effectiveness of FRC regulation.
- II) specific proposals in relation to FRC regulation.

We have already implemented some of the actions we are proposing in response to the feedback received. In particular, we:

- implemented, from September 2008, an updated policy for publishing consultation responses on our website
- provided, from September 2008, an overview of all current consultations on the website
- provided additional training for FRC staff during July and September to ensure that we can continue to follow best practice in preparing impact assessments.

In the longer term (during autumn 2008), the responses to the consultation have helped us to further develop our planning process, which we believe is fundamental to ensuring that we maintain a proportionate and cost-effective regulatory regime. In particular:

- We have reviewed our Strategic Framework, which defines our overall aim - well-founded confidence in corporate reporting and governance - and six Strategic Outcomes which we believe contribute to that aim. We will align Strategic Outcome Six, which relates to our own effectiveness as a regulatory authority, more closely with the Better Regulation Executive principles of good regulation.
- We will be extending our risk assessment and planning horizon to cover a three year period. We believe that this will help us to focus on the longer-term, bigger issues and increase the transparency and predictability of our planning process. We propose to issue, in December, a consultation paper on our updated Strategic Framework and draft Three Year Plan 2009-12.

Two - General comments on the FRC's approach to good regulation

The FRC is committed to the Better Regulation Commission five principles of good regulation: proportionality, targeting, consistency, transparency and accountability. This approach is reflected in Outcome Six of our Strategic Framework

Our Regulatory Strategy (most recently updated in November 2007) includes a set of regulatory principles based on the five principles of good regulation:

- 1) Work on the basis that a well-informed market is the best regulator but, in relation to some of our responsibilities, we have been given significant powers and we do not hesitate to use them where appropriate.
- 2) Target the use of our powers, taking a proactive, risk based and proportionate approach, making effective use of impact assessments and having particular regard to the impact of regulation on small enterprises.
- 3) Emphasis principles and clarity in our standard-setting and rule-making and seek to ensure, as far as it is appropriate to do so, that we are consistent with international standards.
- 4) Be consultative – involving preparers, auditors, actuaries, users of corporate reports and other regulatory organisations in our decision-making and allowing adequate time for consultation without compromising our independence or confidentiality.
- 5) Recognise the importance of professional judgement in the way in which standards and rules are applied and enforced.
- 6) Where we discharge a judicial or quasi-judicial function, do so in accordance with our formal powers and the rules of natural justice.
- 7) Be transparent, accountable and efficient in our work, and ensure that information about our work is presented in a timely and easily accessible fashion to our stakeholders and the public.

We received a number of responses to the consultation which are relevant to the way in which we implement principles 1 to 4 and principle 7 in particular:

Principle 1 - We work on the basis that a well-informed market is the best regulator.

The responses to the consultation were generally supportive of our broad approach to our regulatory responsibilities.

It was suggested that the FRC and our Operating Bodies could engage earlier with stakeholders on regulatory proposals to establish that the drivers of quality in corporate reporting and governance have been correctly identified.

We value the feedback we receive from stakeholders on our regulatory proposals. We believe that our proposed enhancements to our planning and consultation processes will improve our ability to engage with stakeholders about the overall direction of FRC regulation and the important links between the different aspects of our work.

Principle 2 - We target the use of our powers, taking a proactive, risk based and proportionate approach.

Impact assessments

It was suggested that the FRC and our Operating Bodies could improve the quality and depth of impact assessments, particularly in analysing potential costs and benefits.

We have published guidance on our approach to impact assessments and continue to encourage input from stakeholders on all aspects of our proposals. FRC staff have received additional training from BERR on preparing impact assessments.

Impact of FRC regulation on SMEs

A number of suggestions were made in relation to SMEs including a suggestion to improve their representation (particularly through creating an SME panel), a request to not apply a one size fits all approach and a suggestion to look at ways of aligning all accounting requirements for SMEs so that only one set of accounts needs to be prepared.

The application of statutory reporting requirements to particular categories of entity is a matter for Government. The FRC and its Operating Bodies are, however, alert to the needs of SMEs and both the Accounting Standards Board (ASB) and Auditing Practices Board (APB) maintain SME panels. We promote principles based standards that can be applied by all companies but will continue to provide tailored guidance, where appropriate for SMEs.

The ASB issued an updated version of the Financial Reporting Standard for Smaller Entities (FRSSE) in June 2008.

We are proposing to include in the draft Three Year Plan 2009-12 a project to assess the overall impact on SMEs of the regulatory framework for accounting and auditing and related services.

Principle 3 - We emphasise principles and clarity in our standard-setting and rule-making

It was suggested that the FRC and its Operating Bodies should continue to harmonise, where possible, UK standards with international standards, and consult appropriately with overseas regulators on new initiatives.

This is something that the FRC already does, as far as is appropriate, and intends to continue to do so.

It was also suggested, in this context, that we should review the role of the ASB and the APB in the light of the increasing adoption of international standards.

Each year as part of our planning process we review the focus of activities for our Operating Bodies. The ASB and APB devote significant effort to the international aspects of corporate reporting and auditing standards respectively.

Principle 4 - We are consultative

It was suggested that the FRC and its Operating Bodies could improve the consultation process, by providing advance notice of consultations, taking account of other pressures on potential respondents (e.g. the auditing calendar) and reducing the number of consultations.

In response, the FRC has implemented a new policy on the publication of consultation responses, developed the FRC website to include a drop down menu listing all current consultations and responses, and is also publishing a consultation summary, indicating planned, open and closed consultations and expected publication dates.

Principle 7 – We aim to be transparent, accountable and efficient in our work

It was suggested that the FRC should improve the transparency of its decision making through more systematic publication of agendas and minutes, and on-line publication of consultation responses.

Where practical the agendas and minutes of the Operating Body Board meetings are published on the web. We now also publish UITF agendas and minutes on the ASB section of the FRC website.

We will consider other ways in which we can communicate the forward agenda of our Operating Bodies and their deliberations in a more transparent and consistent way, using the FRC website, while continuing to recognise the necessary degree of confidentiality in relation to some of our decision-making processes.

We have updated our policy on the on-line publication of consultation responses, committing to publish all responses on our website within 10 days of receipt unless specifically requested not to.

Three - Specific proposals in relation to FRC regulation

We received a number of suggestions in relation to FRC regulation. These suggestions, together with our response, are set out in relation to Strategic Outcomes One to Five:

Strategic Outcome One – Corporate governance

UK companies with a primary listing in the UK are led in a way which facilitates entrepreneurial success and the management of risk.

Disclosures in relation to the requirements of the Combined Code

It was suggested that the FRC should do more to encourage meaningful disclosures in relation to the combined code.

The preamble to the revised Code published in June 2008, encourages more meaningful disclosure, and in particular more informative explanations when a company does not comply with the code.

We propose to include in the draft Three Year Plan 2009-12 a project to consider how to encourage more explicit explanation of business models by boards in annual and other reports to investors and other interested parties.

Guidance on adequate accounting records

It was suggested that the FRC should provide timely guidance on adequate accounting records.

The project, published in our 2008/09 Plan to develop guidance, as necessary, in relation to changes in the Companies Acts relevant to the meaning of adequate accounting records will address this issue.

Strategic Outcome Two – Corporate reporting

Corporate reports contain information which is relevant, reliable, understandable and comparable, and are useful for decision-making, including stewardship decisions.

Project to consider the complexity and relevance of corporate reporting

A number of respondents expressed particular support for this project. It was suggested that the FRC should publish the objectives of the project.

Details of the aims and remit of the project have been published on the FRC website. The Complexity Advisory Panel met for the first time in July 2008.

Removing standards and guidance that are no longer relevant

It was suggested that the FRC should undertake an exercise to remove old standards and guidance that are no longer relevant, specifically UITF 21 (relating to the adoption of the Euro).

This suggestion has been noted and we will consider it once we have finalised the strategy for the future of UK GAAP.

Strategic Outcome Three – Auditing

Users of audit reports can place a high degree of reliance on the audit opinion, including whether financial statements show a true and fair view.

Guidance on auditor liability agreements

It was suggested that the FRC should provide clear and appropriate guidance on auditor liability limitation agreements.

The guidance published on 30 June 2008 addressed this issue. The guidance, along with further information on these agreements, is available on the FRC website.

Adoption of international standards on auditing (ISAs)

It was suggested that the cost-effectiveness of adopting the new International Auditing Standards (ISAs) should be reviewed and the FRC should avoid adding UK specific requirements to ISAs especially in relation to going concern.

The APB consulted on the adoption of the new ISAs in October 2008, including information relating to the possible costs and benefits. If, following this consultation, the decision is made to adopt the new ISAs the APB will consider carefully the need to maintain the existing UK specific requirements and will consult on this in 2009.

Audit inspections

It was suggested that the AIU should focus on its risk based inspections.

The AIU will continue to allocate its resources in accordance with an assessment of the relative levels of public interest and risk involved, thereby ensuring that the principal focus of independent inspection is on those audit firms and individual audits where the level of public interest and risk is highest.

It was also suggested that the FRC should cease normal inspection activities during the busy period.

The AIU recognises that activity during the peak audit period cause some difficulties however it is not practicable to cease all inspection activities for 2-3 months of the year.

Where possible the AIU tries to mitigate the impact of inspection activity during the busiest audit period.

For example:

- a flexible staffing model is used for some staff
- senior staff focus mainly on firm-wide procedures and report preparation
- some work for the public sector is undertaken during this period on a contractual basis.

Ethical standards for auditors

It was proposed that the FRC should adopt the IFAC Code of Ethics in replacement of the APB's Ethical Standards for Auditors.

As stated in our response to feedback on our Draft Plan & Budget 2008/09 we will continue to contribute to the IESBA's project to revise and clarify the IFAC Code of Ethics. However, we do not agree that we should replace the APB's ethical standards with the IFAC Code at this time. Important issues remain regarding aspects of the IFAC Code including its clarity and the degree to which it reflects the requirements of EU legislation. The APB has consulted on changes to Ethical Standards. The responses supported the APB's view that the Ethical Standards are proportionate to their purpose and working in practice.

Concentration in the audit market

There was a suggestion that the Market Participants Group (MPG) proposals could inhibit competition and overall choice in the audit market.

We do not accept that this is the case. The recommendations of the MPG were based upon extensive consultation. Their report set out actions that could be taken by market participants working collectively, some of which require support from regulators, to allow the market to work more efficiently. The recommendations aimed to enhance the efficiency of the audit markets and to mitigate the risks associated with a major firm leaving the market.

We published the second progress report on the implementation of the MPG recommendations in November 2008, including the feedback to the consultation contained in the first Progress Report and other relevant developments

Inspections of professional bodies

It was suggested that the Professional Oversight Board (POB) should simplify and reduce the frequency of its inspections of professional bodies.

The POB devotes a modest resource to the inspection process. Two staff are engaged in inspection activity in relation to the six professional bodies. The POB has already moved to targeting its inspections on specific areas rather than covering all areas every year, thereby reducing the regulatory burden on the professional bodies.

The POB regularly discusses with the RSBs and RQB opportunities for them to reduce the regulatory burdens imposed on their members whilst maintaining compliance with the relevant legislation.

Strategic Outcome Four – Actuarial practice

Users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility.

No specific suggestions in relation to actuarial standards and regulation were received. The FRC is, however, conscious of the importance of maintaining cost-effective regulation in this area.

Strategic Outcome Five – Professionalism of Accountants and Actuaries

Clients and employers of professionally qualified accountants and actuaries and of accountancy and actuarial firms can rely on them to act with integrity and competence, having regard to the public interest.

Independent disciplinary arrangements

There was a suggestion that there might be consideration of how to ensure that the costs of investigating and hearing AADB cases are kept as low as possible. It was also suggested that the AADB could consult more fully with professional bodies regarding proposed expenditure and before deciding to pursue costs and fines following a successful case.

The AADB makes decisions within the framework of the relevant Scheme. In January 2008, the AADB published a consultation document on proposals for changes to its Accountancy Scheme. The Board developed its proposals following a wide-ranging review of the Accountancy Scheme. The proposed changes are designed to uphold the principles of fairness, transparency and proportionality, which are considered to be the hallmarks of effective, independent regulation and to ensure the continued provision of a “demonstrably fair, independent and expert system for investigating and, where appropriate, hearing significant public interest disciplinary cases” (AADB Aims and Objectives). Following that consultation final proposals have been drawn up, which the AADB expects to make public soon.

The managing Board of the AADB performs an oversight function in relation to case costs and considers budget requests closely. AADB staff maintain an ongoing dialogue with the relevant professional bodies in respect of proposed and actual expenditure on individual cases. It keeps case costs under regular review

and will explore opportunities to enhance the cost-effectiveness of its investigations while ensuring that they remain effective, thorough and fair.

Four - Conclusions

We will incorporate the feedback set out in this paper in our draft Three Year Plan 2009-12 as appropriate and will keep under review the implementation of the actions we have taken, or are planning, to improve the cost-effectiveness of FRC regulation.

Any comments on this feedback statement, or any other aspect of the cost-effectiveness of FRC regulation, should be sent to David Andrews, FRC Policy and Planning Manager, at *planning@frc.org.uk*.

Annex A

We received the following responses to the consultation:

One response from a business organisation:

- CBI

Two responses from investor organisations:

- ABI
- IMA

Six responses from the accountancy profession and audit and advisory firms:

- Consultative Committee of Accountancy Bodies
- Deloitte & Touche LLP
- Ernst & Young LLP
- Grant Thornton UK LLP
- KPMG LLP
- PricewaterhouseCoopers LLP

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