



FINANCIAL REPORTING COUNCIL

REGULATORY STRATEGY

DECEMBER 2004



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One - Introduction

The Financial Reporting Council (FRC) is the United Kingdom's independent regulator for corporate reporting and governance. Following reviews of the existing regime which were undertaken in 2002, the Government significantly expanded the scope of our responsibilities and powers, creating from 1 April 2004 a unified regulator with the wide range of functions set out in Section Two.

This document sets out our strategy, which consists of:

- our aim and objectives
- our regulatory philosophy
- our approach to achieving our objectives
- our governance, funding and accountability

We will also publish an annual Plan & Budget that sets out our priorities for each year and the funds we require to achieve them.

We would welcome comments on our strategy and on any other aspects of our work. Contact details are provided in Annex F.

A list of the abbreviations used in this document is provided in Annex E.

Two - Aim and objectives

Our aim is to promote confidence in corporate reporting and governance.

In pursuit of this aim our five key objectives are to promote:

1. high quality corporate reporting
2. high quality auditing
3. high standards of corporate governance
4. the integrity, competence and transparency of the accountancy profession
5. our effectiveness as a unified independent regulator

The functions we exercise in pursuit of our five key objectives can be summarised as follows:

- setting, monitoring and enforcing accounting and auditing standards
- statutory oversight and regulation of auditors
- operating an independent investigation and discipline scheme for public interest cases
- overseeing the regulatory activities of the professional accountancy bodies
- promoting high standards of corporate governance

We believe that there are strong connections between the issues of corporate reporting, auditing, corporate governance and the professionalism of accountants. We believe that the breadth of our responsibilities and functions enhances our effectiveness.

Our functions are exercised by our operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Professional Oversight Board for Accountancy, the Financial Reporting Review Panel and the Accountancy Investigation and Discipline Board) and by the Council. The Committee on Corporate Governance, whose members are drawn from the Council, assists it in its work on corporate governance. Our organisational structure is shown in Annex A. The functions of the operating bodies and the Committee on Corporate Governance are summarised in Annex B.

Some of our functions are supported by statutory powers, or by statutory obligations on other parties to meet our requirements - "quasi-statutory" powers. Some of our functions have no statutory backing but derive their authority from widespread support from our stakeholders. Our powers are summarised in Annex C.

Our activities are mainly directed towards listed companies and companies required to prepare accounts under the Companies Acts, but are also relevant to other organisations required to submit accounts, including public benefit entities, which include most public sector organisations and many other not-for-profit bodies.

Three - Our regulatory philosophy

We believe in wealth creation. We believe that our role in promoting confidence in corporate reporting and governance can make the creation of wealth more likely.

For public benefit entities, we believe in high standards of governance and stewardship and in the best use of resources. We believe that our role can make these outcomes more likely.

We do not regard regulation as an end in itself. We will use our influence and our powers to promote a regulatory regime in which high standards of corporate reporting and governance are seen to contribute to competitiveness, wealth creation and general prosperity - by underpinning the healthy functioning of the market to the benefit of business, investors, employees and other interests, and by enhancing the UK's economic strength in competitive international markets.

Significant aspects of the regulatory policy for corporate reporting and governance are now decided or heavily influenced by European or global organisations. We, therefore, place great importance on our ability to influence these organisations, with a view to ensuring that as far as possible international approaches contribute to wealth creation, are proportionate, and do not impose unnecessary burdens.

We believe that we should add value through our activities and that our approach should be proportionate to the issues we are addressing. We will pay close attention to signals from the market, from investors and from other interests to ensure - through consultation and research - that we do add value and do not impose unnecessary burdens.

We are committed to the Better Regulation Task Force principles of proportionality, targeting, consistency, transparency and accountability. We will:

- Work on the basis that a well-informed market is the best regulator
- Target the use of our powers, taking a proactive, risk-based and proportionate approach, making effective use of Regulatory Impact Assessments
- Emphasise principles and clarity in our standard-setting and rule-making
- Be consultative - involving preparers, auditors, users of corporate reports and other regulatory organisations in our decision-making and allowing adequate time for consultation, without compromising our independence or confidentiality
- Actively help to shape EU and global approaches to accounting, auditing and corporate governance in ways that contribute to international confidence in corporate reporting and governance and to wealth creation
- Be transparent, accountable and efficient in our work, and ensure that it receives appropriate publicity.

We believe that companies, supported by their professional advisers and encouraged by the investor community, have the primary responsibility for achieving high standards of corporate reporting and governance. An ethical approach to business should make the achievement of these standards more likely. We are very clear that no system of regulation can ever eliminate the possibility of corporate reporting or governance failures; we believe that it is impossible to achieve zero failure and any attempt to do so would destroy wealth rather than facilitate its creation. We can, however, influence the actions of those responsible for corporate reporting and governance.

Four - Our approach to achieving our objectives

This section sets out the main streams of work we are undertaking in pursuit of our five objectives.

These streams of work address our statutory responsibilities and our view of the greatest risks to confidence in corporate reporting and governance. Risks to confidence arise from a number of sources, including behaviour and perceived motivation, external factors that result in corporate failures, and economic and technological developments. We are alert to developments in the markets that may affect confidence in corporate reporting and governance and require a response from us.

The main work streams contributing to our five objectives are as follows:

Objective 1 - Promote high quality corporate reporting

- a) Contributing to the development and implementation of IFRS
- b) Influencing EU policy on accounting standards, including the endorsement of IFRS
- c) Making progress on the convergence of UK accounting standards with IFRS
- d) Improving other aspects of UK accounting standards
- e) Improving communications between companies and investors, including developing and implementing standards for the OFR
- f) Pro-actively enforcing accounting and other corporate reporting standards
- g) Influencing EU policy and practice on the enforcement of accounting standards

Objective 2 - Promote high quality auditing

- a) Contributing to the development and implementation of ISAs
- b) Making progress on the convergence of UK auditing standards with ISAs
- c) Improving other aspects of UK auditing standards and guidance
- d) Improving ethical standards for auditors in the UK
- e) Undertaking specific statutory duties of regulation in relation to auditing and the supervision of the auditing profession by the recognised supervisory and qualifying bodies
- f) Monitoring the quality of the auditing function in relation to listed companies and any other entity in whose financial condition there is a major public interest
- g) Contributing to UK government input on proposed EU legislation and policies on audit; and working with Government to implement them
- h) Promoting increased cooperation among international independent audit regulatory authorities

Objective 3 - Promote high standards of corporate governance

- a) Maintaining an effective Combined Code on Corporate Governance and promoting its widespread application
- b) Ensuring that the guidance on internal control and audit committees is current and relevant
- c) Influencing EU and global corporate governance developments
- d) Helping to promote boardroom professionalism and diversity
- e) Encouraging constructive interaction between company boards and institutional shareholders

Objective 4 - Promote the integrity, competence and transparency of the accountancy profession

- a) Overseeing the way in which the professional bodies exercise their regulatory responsibilities in relation to their members
- b) Operating an independent investigation and discipline scheme for matters which raise or appear to raise important issues affecting the public interest
- c) Establishing standards and related guidance for accountants providing assurance services

Objective 5 - Promote our effectiveness as a unified independent regulator

- a) Ensuring that we have adequate resources and management processes
- b) Meeting the principles of good regulation and ensuring that we are transparent and accountable and demonstrate our effectiveness
- c) Developing cooperative arrangements with other regulatory organisations whose activities are relevant to our objectives
- d) Ensuring that we are recognised in the UK and internationally as a credible, authoritative and influential organisation

Our annual planning process, based on an April-March operating year, will establish:

- annual priorities for each work stream
- the resources that are needed to achieve these priorities

We will publish our Plan & Budget by January to give stakeholders and other interested parties the opportunity to comment well before the start of the operating year.

Five - Governance, funding and accountability

Governance

We will put in place arrangements for our governance that comply with the relevant aspects of the Combined Code on Corporate Governance. The roles of the principal decision-making groups within the FRC are summarised below. Up-to-date information on the membership of these groups is published on our website.

The Board of FRC Ltd:

- Determines our strategy and priorities
- Sets our budget, secures the necessary funding and monitors our expenditure
- Oversees the delivery by each operating body of their functions
- Makes appointments to the Council, the operating bodies and senior management
- Approves any significant structural changes to the FRC
- Ensures that the FRC and its operating bodies achieve high levels of accountability and transparency
- Manages our relationship with key players domestically and internationally and the overall public relations framework.

The Directors are appointed by the Secretary of State for Trade and Industry. They are assisted in the discharge of their responsibilities by the Chief Executive.

The Council:

- Monitors the Combined Code on Corporate Governance and approves any changes to the Code and related guidance
- Provides advice on our strategy and priorities
- Gives advice on our budget and funding
- Gives advice on structural and any other relevant issues
- Monitors and gives advice on our activities on the basis of regular reports from all parts of the FRC

The Council has up to 30 members (including the 5 Directors of FRC Ltd, the chairs of the operating bodies, and the Chief Executive), and in addition a number of observers from other bodies with an interest in our work. It has wide and balanced representation from the business, investor, professional and other communities with an interest in corporate reporting and governance.

The operating bodies:

- Make the regulatory decisions for which they are responsible
- Keep under review any emerging risks or other matters which could affect those aspects of confidence in corporate reporting and governance which fall within their remits
- Make appointments to working groups and committees, in consultation, where appropriate, with the Chair of the FRC

Funding

We are funded by the UK government, the accounting profession and by the business community (currently through listed companies). Details on our approach to managing our costs and the way in which we are funded are contained in our Financial Management and Reporting Framework, which is set out in Annex D.

Accountability

There are several ways in which we will ensure that we are accountable for our work.

Consulting on our work plans

- We will publish and invite comments on our annual Plan & Budget.

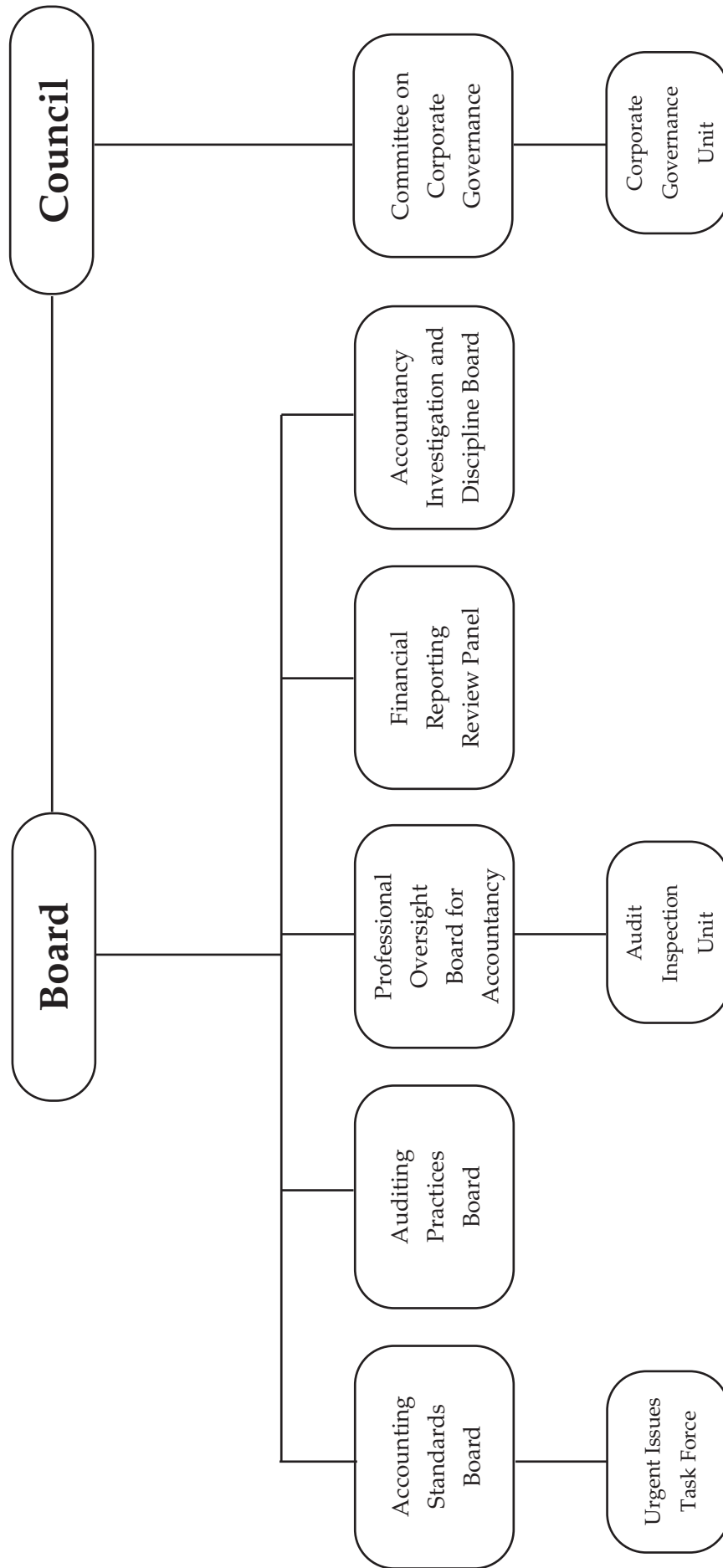
Reporting on our performance

- We will publish up to date information about our work, including summary minutes of meetings of the Board, Council and our operating bodies, subject to issues of necessary confidentiality.
- As part of our annual planning process, we will assess and report on our performance, identify the progress we are making in achieving our objectives, and demonstrate our effectiveness and our efficiency in the way we use our resources.

Making ourselves open to scrutiny

- We will make ourselves available for scrutiny by external auditors, by Parliament, by stakeholders, and by the public (through an Annual Open Meeting).

Annex A - Organisational structure



Annex B - Operating bodies and the Standing Committee on Corporate Governance

The **Accounting Standards Board (ASB)** contributes to confidence in corporate reporting and governance by establishing and improving standards of financial accounting and corporate reporting.

The ASB's functions are to:

- Develop principles to guide standards and to provide a framework within which others can exercise judgement in resolving financial accounting and corporate reporting issues.
- Issue new accounting standards, or amend existing ones, in response to evolving business practices, new economic developments and deficiencies identified in current practice.
- Address urgent issues promptly through the UITF.
- Work with the IASB, with national standards-setters and relevant EU institutions, including the EFRAG, to encourage high quality in the IASB's standards and their adoption in the EU.

The **Auditing Practices Board (APB)** contributes to confidence in corporate reporting and governance by setting standards and giving guidance: for the performance of external audit and other activities undertaken by accountants that result in reports or other output that is published, required by law or otherwise relied upon in the operation of the financial markets ('assurance services'); and in relation to the independence, objectivity and integrity of external auditors and the providers of assurance services.

The APB's functions are to:

- Establish Auditing Standards which set out the basic principles and essential procedures with which external auditors in the United Kingdom and the Republic of Ireland are required to comply.
- Issue guidance on the application of Auditing Standards in particular circumstances and industries and timely guidance on new and emerging issues.
- Establish standards and related guidance for accountants providing assurance services.
- Establish Ethical Standards in relation to the independence, objectivity and integrity of external auditors and those providing assurance services.
- Take an active role in the development of statutes, regulations and accounting standards which affect the conduct of auditing and assurance services, both domestically and internationally.
- Contribute to efforts to advance public understanding of the roles and responsibilities of external auditors and the providers of assurance services, including the sponsorship of research.
- Work with the IAASB to encourage the development of high quality ISAs and their adoption in the UK.

The **Professional Oversight Board for Accountancy (POBA)** contributes to confidence in corporate reporting and governance by strengthening the independence and transparency of the regulatory regime for auditing and for the accountancy profession.

POBA's functions are to:

- Discharge the statutory responsibilities to be delegated by the Secretary of State for authorising professional accountancy bodies to act as supervisory bodies and/or to offer a recognised professional qualification.
- Monitor the audit quality of economically significant entities through the AIU. The unit will monitor audit quality by reviewing audit processes including audit judgements.
- Review the regulatory activities of the professional accountancy bodies in relation to their members, including education, training, continuing professional development, standards, ethical matters (except those which are the responsibility of the APB), professional conduct and discipline, registration and monitoring, including making recommendations on how these activities might be improved.

The **Financial Reporting Review Panel (FRRP)** contributes to confidence in corporate reporting and governance by seeking to ensure that the provision by public and large private companies of financial information and other information falling within its remit complies with relevant reporting requirements.

The FRRP's functions are to:

- Carry out its formal responsibilities on behalf of the Secretary of State in relation to annual accounts and other documents falling within its remit.
- Maintain a Panel body that includes a wide and balanced representation, at the most senior level, of businesspeople, accountants, lawyers and preparers and users of accounts such that those who come before the Panel know that they are judged by their peers within the financial reporting community.
- Develop and operate a selective programme of proactive review of annual accounts and other documents falling within its remit which is based primarily on risk assessment.
- Enquire into specific sets of published financial statements and other documents, such as interim financial statements, falling within its remit which come to its attention, whether through proactive review, through complaints, or otherwise.
- Ensure that findings of the Panel concerning any case considered by it are brought to the attention of relevant regulatory bodies so that they can determine whether disciplinary or other sanctions should be applied, and to co-operate with and provide information to such regulatory bodies so far as permissible.

- Liaise with the FSA and other enforcement agencies in the UK and internationally to foster consistent application of accounting requirements and generally to improve the compliance of financial information with relevant reporting requirements.
- Contribute to and seek to sustain an EU approach to enforcement that recognises the effectiveness of the UK arrangements and is vigorous, consistent and cost-effective.
- Promote knowledge, understanding and public recognition within the financial reporting community to maximise the Panel's deterrent effect.

The **Accountancy Investigation and Discipline Board (AIDB)** contributes to confidence in corporate reporting and governance by providing an independent body to investigate the conduct of members or member firms of the professional accountancy bodies and to take disciplinary action in public interest cases - matters which raise or appear to raise important issues affecting the public interest.

The AIDB's functions are to:

- Operate an independent investigation and discipline scheme for matters which raise or appear to raise important issues affecting the public interest.
- Keep under review the working of the Scheme and the supporting Regulations to ensure that they are operating effectively.
- Ensure publicity for the Board's activities and achievements.

The **Committee on Corporate Governance** leads the Council's work on corporate governance.

The Committee's terms of reference are:

- To keep under review developments in corporate governance generally, reflecting the FRC's objective of fostering high standards of corporate governance; to undertake reviews, either directly or by overseeing the work of others, and then to consider whether any actions by the FRC would be desirable; and to put proposals to the Council where appropriate.
- To monitor the operation of the Combined Code on Corporate Governance and its implementation by listed companies and shareholders.
- Where significant doubts are raised about the appropriate interpretation of part of the Code, to consider the case for issuing a clarification, and if appropriate to do so, after any suitable consultation.

The Committee is supported in its work by the CGU.

Annex C - Summary of our powers

Function	Responsibility	Statutory Powers	Brief description
Issuing accounting standards	ASB	Statutory	Section 256(1) Companies Act 1985 as amended by the Companies Act 1989
Addressing unsatisfactory or conflicting interpretations of accounting standards	UITF of ASB	No	CCAB bodies expect their members to observe the consensus reached by the UITF on relevant issues
Issuing reporting standards	ASB	Statutory	Section 257 of the Companies Act 1985 as amended by Section 13 of the C(AICE) Act 2004
Setting standards and giving guidance for the performance of external audit and in relation to the independence, objectivity and integrity of external auditors and the providers of assurance services	APB	Appropriate independent arrangements as described in statute - "quasi-statutory" powers	Paragraphs 7(1A) and 8(2) of Schedule 11 to the Companies Act 1989, as inserted by Section 1 of the C(AICE) Act 2004
Independent oversight of the regulation of the auditing profession by the recognised supervisory and qualifying bodies	POBA	Statutory	Section 46 of the Companies Act 1989, as amended by Section 3 of the C(AICE) Act 2004
Monitoring the quality of audits of economically significant entities	AIU of POBA	Appropriate independent arrangements as described in statute - "quasi-statutory" powers	Paragraph 10A of Schedule 11 to the Companies Act 1989, as inserted by section 1 of the C(AICE) Act 2004

Function	Responsibility	Statutory Powers	Brief description
Independent oversight of the regulation of the accountancy profession by the professional accountancy bodies	POBA	No	CCAB bodies have accepted a commitment to consider carefully POBA recommendations, implement them within a reasonable period or give reasons in writing for not doing so
Seeking to ensure that the provision of financial information by public and large private companies complies with Companies Act requirements	FRRP	Statutory	Section 245C of the Companies Act 1985 as amended by Section 10 of the C(AICE) Act 2004
Enforcement functions in relation to OFR and directors' reports	FRRP	Statutory	Section 257 of the Companies Act 1985 as amended by Section 13 of the C(AICE) Act 2004
Monitoring of compliance with accounting requirements of listing rules by issuers of listed securities	FRRP	Statutory	Section 14 of the C(AICE) Act 2004
Providing an independent investigation and discipline scheme for matters which raise or appear to raise important issues affecting the public interest	AIDB	Appropriate independent arrangements as described in statute - "quasi-statutory" powers	Paragraph 12A of Schedule 11 of the Companies Act 1989 as inserted by Section 1 of the C(AICE) Act 2004
Monitoring and maintaining the Combined Code on Corporate Governance and associated guidance	The Council	No	The FSA's Listing Rule 12.43A requires companies to report on their compliance with the code

Annex D - Financial Management and Reporting Framework

The FRC has a wide range of activities. Some of those activities are subject to specific funding arrangements and/or are likely to experience considerable volatility from year to year (depending on the number and complexity of cases) and, therefore, cannot be subject to firm budgetary limits. The Directors believe that it is helpful to have a framework within which to manage and report on the costs of its activities and how they are funded.

Four types of activities, which have distinct cost and funding characteristics, have been identified.

Core operating activities

- Our core operating activities cover all of our activities other than Audit Inspection, Investigation & Disciplinary Case and Review Panel Case costs.
- The costs of the core operating activities are measured in accordance with applicable accounting standards but the amount of funds raised is adjusted for significant non-cash items, principally depreciation and capital expenditure.
- The funds are provided in equal proportions by the FRC's three sponsors: the accountancy profession (the six major professional bodies); the business community (primarily listed UK companies); and the government. This is the "tri-partite funding arrangement".
- Our intention is to raise in each financial year the funds expected to be required for that year.

Audit Inspection costs

- The Audit Inspection costs include only the specific and variable costs of the AIU. The fixed overheads of the AIU (principally office accommodation and shared IT systems) are included in core operating costs.
- The Audit Inspection costs are met by the individual Recognised Supervisory Bodies with which the firms that are subject to inspection are registered.
- Our intention is to raise in each financial year the costs incurred in that year.

Investigation & Disciplinary Case costs

- The Investigation & Disciplinary Case costs include only the specific and variable costs of cases taken by the AIDB. The other costs of the AIDB (principally staff, accommodation, shared IT systems and other overheads) are included in core operating costs.
- The Case costs are potentially volatile from year to year, depending on the number and complexity of cases and, therefore, cannot be subject to firm budgetary limits.

- The case costs are met by the individual participating bodies to which the members or firms that are the subject of each case belong. In the event of disciplinary complaints being brought, the disciplinary tribunals have powers to award costs against those found guilty of misconduct.
- Our intention is to raise in each financial year the costs incurred in that year.

Review Panel Case costs

- The Review Panel Case costs include only the specific and variable costs of cases which the FRRP decides to take to court or prepares to take to the Courts. The other costs of the FRRP (principally the Director and other staff, office accommodation and shared IT systems) are included in core operating costs.
- The Case costs are potentially volatile from year to year, depending on the number and complexity of cases and, therefore, cannot be subject to firm budgetary limits. These costs are met in the first instance from the Review Panel Case costs fund (see below), which is then replenished in the following financial year under the tri-partite funding arrangement.

Measuring our effectiveness in managing costs

While we will endeavour to ensure that we secure value for money in all our expenditure, the Directors believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs.

Financial Reporting Review Panel Case costs fund

The Directors have for many years maintained a fund to enable the FRRP to take steps through the Courts to ensure compliance with the accounting requirements of the Companies Act 1985, including applicable accounting standards, and to investigate possible departures from those requirements and standards. The level of the fund in recent years has been set at £2m but is kept under review by the Directors. The Directors have undertaken to consult the sponsors on any proposal to vary the level of the fund.

Reserves

The Directors believe that it is prudent for the FRC to maintain reserves to meet unforeseen expenditure. The level of reserves in recent years has been around £0.5m but is kept under review by the Directors. The Directors have undertaken to consult the sponsors on any proposal to vary the level of reserves.

Annex E - Abbreviations

AIDB	Accountancy Investigation and Discipline Board
AIU	Audit Inspection Unit
APB	Auditing Practices Board
ASB	Accounting Standards Board
C(AICE)	Companies (Audit, Investigations & Community Enterprise) Act
CCAB	Consultative Committee of Accountancy Bodies
CGU	Corporate Governance Unit
EFRAG	European Financial Reporting Advisory Group
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FSA	Financial Services Authority
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing
OFR	Operating and Financial Review
POBA	Professional Oversight Board for Accountancy
UITF	Urgent Issues Task Force

Annex F - contact details

Comments on the Regulatory Strategy should be sent to:

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For general information about the work of the FRC, please see our website at: www.frc.org.uk

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