16 February 2017

Mr David Andrews
The FRC
8th Floor
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Dear Mr Andrews

THE FINANCIAL REPORTING COUNCIL (FRC) DRAFT PLAN & BUDGET AND LEVY PROPOSALS 2017/18

Introduction

CCAB welcomes the opportunity to comment on the above consultation document issued by the FRC in December 2016.

About CCAB

The combined membership of the five CCAB bodies – ICAEW, ACCA, ICAS, CIPFA and Chartered Accountants Ireland – amounts to some 260,000 professional accountants in the UK and the Republic of Ireland (380,000 worldwide).

CCAB provides a forum for the bodies to work together collectively in the public interest on matters affecting the profession and the wider economy.

CCAB's credibility stems from its insight into all areas of finance and accounting, from finance director and audit partner to management accountants, professional advisers, public sector finance leaders and entrepreneurs. CCAB's members work through the financial value chain in all sectors as key decision makers and business leaders within the UK and around the world.

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GENERAL COMMENTS

As acknowledged, the exit of the UK from the EU will present challenges and opportunities in the coming years as well as a degree of uncertainty. The CCAB bodies are committed to working together to support the FRC in ensuring as smooth a transition as possible to the new arrangements and fully agree that the key overriding objective should be the maintenance of the UK's standing as a global centre of excellence for accountancy, audit and actuarial work. We hope that the FRC recognises the need to keep the professional accountancy bodies closely involved, and informed of, developments in this regard, particularly in protecting professional recognition within Europe.

We welcome the FRC's desire to adopt a conservative approach, and to seek minimal inflationary increases to its spending where possible. To this extent, the CCAB contribution to standards and oversight has increased from £4.1m to £4.2m (an increase of 2.4%). This is a significant improvement on any prior year budget, and is to be commended, subject to our comments below.

We continue to have concerns about the lack of transparency and detail in the proposals. Each year the FRC identifies priority areas, which are then used to explain planned increases in expenditure. It follows that, when these cease to be priority areas, expenditure in those areas should decrease. The proposals in the draft plan and budget will continue to lack transparency while such opportunities for cost savings remain unidentified.

More broadly, the lack of detail in the draft plan invites the criticism that the FRC sets its own agenda in many areas; then determines the level of funding required to deliver the activities; and then imposes the funding requirements on the profession. In particular, the draft plan appears to be light on detail as to how the FRC intends to deliver on the priorities of:

- enhancing the speed and effectiveness of the FRC's enforcement role, and
- ensuring that the FRC is effective and efficient, and has a corporate culture that supports its mission and regulatory role,

and what they will cost (or the cost savings generated by the efficiencies).

It seems (from the statement at the top of page 3 of the proposals document) that the actual spend for 2016/17 will be at least £500,000 less than budgeted. This is not reflected in the tables on pages 14 and 15, which makes comparison difficult. We continue to have concerns about transparency regarding anticipated costs and the rationale behind the building up of reserves.

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The headline regarding the FRC's proposed funding requirement is that its 'funding requirement is budgeted to increase by 4% from £34.6m to £36.0m'. However, this includes the proposed increase in reserves, which is misleading. The truer comparison is between the proposed spend on regulatory activities in 2017/18 (£35.3m) against the actual spend for 2016/17 (now thought to be no more than £33m after the £0.5m saving discussed above). This, in fact, represents a 7% increase (8.2% if audit and accountancy case costs are omitted from the calculation).

The proposed high increase in staff costs (7.5% on the previous year) has been accounted for (on page 3 of the proposals document) as follows:

(a) the flow through of the additional resources necessary to fulfil the FRC's obligations following its appointment as the Competent Authority in the UK for audit
(b) ongoing efforts to accelerate the speed of investigations in the FRC's Enforcement activities
(c) the development of the UK's corporate governance framework following publication of the Government's Green Paper and BEIS Select Committee Inquiry.

However, with regard to point (a), the additional responsibilities of the FRC as Competent Authority have not been clearly articulated in the proposals document, and so the expected impact of this on costs cannot be easily quantified. The clearest indicator of the FRC's additional responsibilities is in respect of the number of individual audit engagements that will be reviewed each year. The draft plan indicates that approximately 155 audit engagements will have been reviewed in 2016/17, compared with 137 in 2015/16. We are told that staff resources have increased over recent years, but that they are expected to increase further. Given that the systems for conducting reviews and reporting the findings are already established, it is not clear that a further increase in the number of reviews will require a further increase in staff. In short, the proposed 5.5% increase in AQR costs, from £7.3m to £7.7m, lacks transparency.

The proposed increase to Enforcement core costs (point (b)) is £0.5m. The FRC and the Participant Bodies are openly discussing the future of the Accountancy Scheme ('the Scheme'), and in particular whether the scope should be more closely focused on the obligations conferred on the FRC by the EU Audit Regulation and SATCAR (and the amendments to Schedule 10 of the Companies Act). This would result in a Scheme which would only consider cases involving the audit of a PIE, and extend to include individuals involved with the preparation and presentation of the financial statements. Against that background, it is troubling to suggest that core costs should be increasing by £0.5m. We do not have any visibility of the underlying business case for the increase. The budget proposal would seem to imply that any increase in core costs is expected to be recurring, whereas the review of the Scheme would suggest that any costs should be non-recurring beyond the conclusion of the cases currently under consideration (many of which ought to be concluded within the life of this budget). We recognise the need to deal with cases quickly and effectively. The FRC bears the reputational and operational risks of cases within the Scheme, but the profession carries

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the financial risk. The Enforcement team has a current budget of £7.9m. The objective of securing more effective and efficient regulation of the cases under consideration ought to be capable of being achieved without increased costs to the profession. We have previously invited the FRC to consider whether its objectives could be equally achieved through the re-calibration of existing resources, as all the CCAB bodies must do in relation to their own operations. We want to better understand the rationale for the cost increase, and reiterate the request that the FRC consider how it can deliver its objective without placing a further financial burden on the profession (given the Participant Bodies are paying the case costs separately).

With regard to developments in corporate governance (point (c)), it was stated at the FRC's open meeting on 1 February 2017 that uncertainty in this area will require an increase in reserves. We are not convinced that the case for this has been made in the proposals paper, which claims that the continuing build-up of reserves is, in fact, due to the voluntary nature of much of the FRC's funding.

SPECIFIC QUESTIONS

In this section, we set out our responses to the specific questions set out within the consultation document.

Question 1: Do you have any comments on our proposed priorities and work programme for 2017/18?

According to the proposals paper, the proposed priorities for 2017/18 are:

- in the light of concerns about trust in business, updating the Corporate Governance Code and associated guidance, and promoting effective investor stewardship
- playing an active role with other regulators in helping address the challenges and opportunities of Brexit, and remaining influential internationally
- enhancing the speed and effectiveness of the FRC's enforcement role
- promoting clear and concise corporate reporting
- promoting justifiable confidence in auditing
- promoting high quality actuarial work
- ensuring that the FRC is effective and efficient, and has a corporate culture that supports its mission and regulatory role.

The plan and budget indicate the additional work in some of these priority areas (most notably in the area of corporate governance), but it is far from clear what additional work it will perform in other priority areas such as Brexit, corporate reporting, auditing and corporate culture. In particular, the FRC may be expected to take a leading role in assessing the Brexit implications (given its mission is to promote high quality corporate governance and reporting to foster investment). Little of any impact may be achieved until the likely outcomes of Brexit negotiations become clearer. However, it would be useful to have an indication now of where the most significant activities and costs will fall.

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The FRC's activities with EFRAG (including the related costs) might be expected to fall in due course. However a clear statement that the FRC will support IFRS for UK listed companies in a post-EU world would be helpful.

We have already commented on the lack of detail in the draft plan, particularly in respect of delivering:

- enhanced speed and effectiveness of the FRC's enforcement role, and
- greater effectiveness and efficiency, and a corporate culture that supports the FRC's mission and regulatory role.

With regard to the corporate reporting priorities, the proposed spend on reviewing corporate reports (£4.0m) is significant. The alternative would be reverting to a complaint-driven system (as existed before IFRS adoption in 2005).

The proposed spend on accounting and reporting seems relatively high at £2.9m. Given that the new UK GAAP (FRS100 to 105) is now in place, one might expect to see the figure being reduced and resources redeployed. We acknowledge that the FRC has an on-going role in seeking to influence the IASB. However, we are unclear about how effective that process has been and wonder if the FRC has carried out an assessment of its effectiveness.

We believe that the work of the Financial Reporting Lab continues to be well-received, and is seen as high quality and influential. However, there remains a need to consider value for money regarding all such activities that are not core regulatory functions of the FRC. More generally, we believe that the plan should set out how the FRC determines which activities to pursue (or to abandon), and how costs (and projected benefits) are assessed.

Question 2: Do you have any comments on our proposed effectiveness indicators?

We agree that it should be a priority of the FRC to enhance the speed and effectiveness of its enforcement role. However, no effectiveness indicators have been proposed in the draft plan. This is surprising given the data that must surely be available to the FRC which allows it to make the statement on page 7 of the draft plan:

'During 2016/17, the Enforcement Division has […] continued to reduce the length of time of investigation. The team has expanded since 2013, reflecting the importance we attach to our enforcement role. We plan further to expand the Team in 2017/18.'

As indicated above, and in light of increased costs since 2013, without clear effectiveness indicators, the plan to further expand the Team is not supported.

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More generally, some of the suggested effectiveness indicators do not appear to be 'SMART'. This would appear at odds with past FRC recommendations to the RSBs that their action plans should be more SMART. It is reasonable to expect that the final plan for 2017/18 will identify clear, measurable KPIs, rather than place reliance on rather generic indicators (eg reference to survey results, 'The impact that our oversight procedures have on the actuarial profession', etc.)

Question 3: Are there any areas where the FRC could reduce its proposed activities without reducing the overall impact of FRC regulation?

There may, in fact, be areas in which the FRC's proposed activities themselves reduce the FRC's effectiveness, as those activities conflict with the FRC's regulatory responsibility (eg guidance produced to support the entities it regulates). Perhaps of similar concern is the intention to monitor corporate culture (and audit firm culture), given the statement on page 1 that the FRC has 'during 2016 promoted the importance of good corporate culture'.

It is difficult to respond to this question in relation to specific priorities, given the lack of transparency around the prioritisation of each activity, its costs and anticipated benefits. It is difficult to identify those activities that are core to the FRC's regulatory responsibilities, rather than simply 'nice to have'.

Page 8 of the consultation talks about Brexit having significant implications, and states:

'The extent to which the framework for accounting and reporting will need to change will depend to a large degree on the outcome of the UK Government's negotiations with the EU.'

We question the relevance of this, given that the outcome of the UK Government's negotiations with the EU will not be known within the timespan of the 2017/18 planning period. It is too early to start to build up reserves in respect of the impact of the Brexit negotiations, and so we are unclear about the impact that this statement has had on the proposed budget for 2017/18.

Question 4: Are there any significant risks to the quality of corporate governance and reporting in the UK which are not addressed in the proposed work programme?

The most significant risks to the quality of corporate governance and reporting in the UK attach to entities that are of genuine public interest in terms of their size and function, and the trust placed in them by stakeholders. FRC's responsibilities as Competent Authority for audit in the UK are clear. However, the FRC must stand accountable for how it addresses the risk attaching to PIEs. Effectiveness indicators must be capable of measuring improvements in audit quality and investor confidence.

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Question 6: Do you have any comments on our proposed budget?

A proposed 7.5% increase in staff costs is deemed to be justified by an increase in resources necessary to fulfil the FRC's obligations as Competent Authority for audit, acceleration of investigations (presumably a temporary increase), and development of the corporate governance framework (which seems excessive in light of reduced responsibilities in standard-setting in other areas over the years).

The manner in which the FRC tends to present its draft plan and budget each year enables respondents to the consultation to do little more than compare proposed costs year on year. However, we must question certain costs in absolute terms. For example, the final budget should explain why it might cost £1.9m per year to maintain audit and assurance standards, which are for the most part heavily based on international standards.

The draft plan and budget lacks transparency concerning 'central costs'. What are these costs, and how are they allocated and recovered? The document simply states that the costs of FRC governance and overheads are 'allocated pro rata'. However, 'central costs' only appear under 'Corporate Governance & Reporting' and 'Audit and Assurance Regulation'.

Fundamentally, at a time when many stakeholders are trying to contain costs, we must ask ourselves whether the FRC should be increasing its reserves by a further £0.7m - especially when its overall planned expenditure is increasing significantly, and we are told that reserves have benefitted from an unplanned increase of £0.5m from savings made in 2016/17 (page 3). That £0.5m increase in reserves does not appear to have been accounted for in the table on page 16.

We are aware that the FRC's status may be changed to that of a public body, although the precise type of designation is unknown. This would likely have an impact on the future level of reserves required as the government, if not willing to directly fund the FRC, may be able to underwrite it as a going concern.

Question 7: Do you have any comments on our proposed levy rates?

Increases on funding requirements are contrary to the statement on page 1 of the consultation paper that '[i]n a period when businesses are facing a high degree of uncertainty, regulators need to be wary of creating unnecessary costs for business'.

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The table on page 17, which claims to set out how the funding is to be allocated between various groups, does not explain the basis for the allocation. A mere comparison of the proposal for 2017/18 against the 2016/17 requirement does not provide the appropriate level of transparency.

Yours sincerely

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