



Financial Reporting Council

Draft Plan and
Levy Proposals
2010/11

December 2009

The Financial Reporting Council

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.

The decision-making bodies are the FRC Board and the Operating Bodies:

The FRC Board oversees the organisation as a whole and its work on corporate governance.

The Accounting Standards Board issues accounting standards for the UK and Ireland but, with the move to IFRS, is increasingly focussed on influencing the setting of standards by the IASB.

The Auditing Practices Board issues standards and guidance for auditing, for the work of reporting accountants in connection with investment circulars, and for auditors' integrity, objectivity and independence. It influences the setting of international standards on auditing by the IAASB.

The Board for Actuarial Standards sets technical standards for actuarial practice.

The Professional Oversight Board provides independent oversight of the regulation of accountants and actuaries by their respective professional bodies. It provides statutory oversight of the regulation of the auditing profession by the recognised supervisory and qualifying bodies, and monitors, through the Audit Inspection Unit, the quality of the auditing function in relation to economically significant entities.

The Financial Reporting Review Panel reviews company accounts for compliance with the law and accounting standards.

The Accountancy and Actuarial Discipline Board is the independent investigative and disciplinary body for accountants and actuaries in the UK.

Contents

One	Overview	1
Two	Proposed major activities and projects	4
Three	Draft budget	6
Four	Levy proposals	10
Five	Contact details	12

One – Overview

We propose to address four priorities in 2010/11:

- Helping boards, preparers, audit committees, auditors, actuaries, and investors address the governance and reporting challenges associated with current conditions – and monitoring their response to these challenges.
- Identifying and responding to the longer term lessons of the financial crisis.
- Influencing, and responding to, a range of international initiatives in relation to corporate reporting and governance.
- Enhancing our own effectiveness and efficiency as a regulatory authority.

In addressing these priorities, we will seek to strengthen our links with stakeholders, including the investor community.

Corporate governance

We believe that good corporate governance is essential to the effective operation of a free market. Good governance improves boards' ability to manage effectively as well as providing accountability to shareholders. The more ingrained corporate governance becomes in a business community, the less the need for detailed regulation to ensure effective compliance with good standards of business behaviour. We emphasise the needs of investors for relevant and clearly communicated information on governance, business models and company performance.

Helping to address the challenges of current conditions

Although the economic outlook has improved since we published our Plan for 2009/10, major challenges remain for investors and all those involved in the preparation, audit or review of corporate reports.

Boards still find the assessment and management of risk challenging, particularly those who have changed their business models to help manage the effects of the recession. Such changes often call into question whether accounting policies remain appropriate and whether internal control systems reliably capture all the relevant data. Our new guidance on the current challenges for audit committees focuses on these risks.

The financial crisis has triggered an unprecedented level of debate about accounting issues in financial services. We have led many of the discussions in the UK, the EU and global fora, particularly about the use of fair value. The ASB chairs a group of national standard setters from around the world to ensure that different views are well understood.

Experience shows that insolvencies increase after the technical end of recession as companies run out of working capital. The next twelve months are likely to be difficult for management and there is an increased risk that annual reports and accounts misreport – with associated challenges for auditors and actuaries and implications for the quality of information available to investors. We have published revised guidance to assist directors of all sizes of UK companies to make well-considered assessments on going concern and liquidity risk. We will monitor how the guidance is operating in the market and will take action to intervene further if events require.

As companies emerge from the recession, we anticipate an increase in the level of mergers and acquisitions. We have reviewed financial reporting of significant business acquisitions and concluded that the quality of information should be enhanced to improve understanding of the rationale for acquisitions. The Financial Reporting Reviewing Panel (FRRP) will have a particular focus on this area of reporting in 2010/11. It will also pay particular attention to industries exposed to aggressive cost cutting.

We are conscious of the commercial pressures that major audit firms are under. In our published reports on individual audit firms we consider the actions that firms take to maintain their margins. We have not identified that any individual action has had a direct adverse impact

on audit quality but see a need to remain vigilant. Any prolonged reduction in investment in audit will have a long term impact on audit quality. The Professional Oversight Board's (POB) Audit Inspection Unit (AIU) will have close regard to areas of high subjectivity and professional judgement and to compliance with ethical standards.

The Auditing Practices Board (APB) is currently consulting on the Treasury Select Committee's view that investor confidence in audit would be enhanced by a prohibition on audit firms conducting non-audit work for the same company. It will review its ethical standards for auditors in light of responses to the consultation.

Risk management systems have been severely stressed in 2009. Insurance company directors and pension scheme trustees face the challenge of managing the risks associated with their business models and understanding the key assumptions and cash flows underlying discounted values and the quality controls on actuarial work. Our updated guidance for users of actuarial information focuses on these challenges.

Identifying and responding to the longer term lessons of the financial crisis

The crisis has sent powerful messages about the need for a sustained improvement in governance and board behaviours in the financial sector.

Our review of the effectiveness of the UK Corporate Governance Code (formerly the Combined Code) and the "comply or explain" regime has emphasised that the quality of corporate governance ultimately relies on behaviour not process. Although there is a limit to the extent to which any regulatory framework can deliver good governance, we believe that it is essential to ensure that the framework reflects changing circumstances, including shortcomings in governance in the banking sector, and commands effective support from boards and investors. The review suggested that more attention needs to be paid to the principles set out in the Code, which are intended to encourage appropriate board behaviours. We also saw scope for further improvement in the quality of communication by companies and engagement between companies and investors.

We will promote the conclusions of our consultation on specific revisions to the Code and Sir David Walker's recommendations insofar as they relate to all companies.

The Government has asked us to take responsibility for a stewardship code for institutional investors. Effective investor engagement is essential to the success of the Corporate Governance Code. The FRC welcomes the opportunity to play a leading role in both corporate and investor governance.

We published a discussion paper in June 2009 inviting views on the complexity of corporate reports and seeking practical ways to enhance their relevance for investors. The response to the discussion paper suggested that we have identified the right areas on which to focus, including the framework for disclosures and issues around materiality. We will push hard in 2010/11 to stimulate real change in behaviours from regulators, preparers and auditors.

Our 2009 review of narrative reporting also suggests that few companies provide a full disclosure of their business model, although most provide some description of their business. The impact of tough economic conditions has made clear the importance of the disclosure of business models and there is a case for a more explicit legal requirement to be introduced. We will pursue this issue in 2010/11. The APB will also consider the ways in which audit reports might be developed further to provide additional information to shareholders.

A further, long-term task for the FRC is the reform of the framework of actuarial standards. The Board for Actuarial Standards (BAS) have begun to issue a series of new, principles-based standards focusing on the needs of users of actuarial information. The BAS's first standard, Reporting Actuarial Information, which comes into effect in April 2010, is fundamental to better risk management for pension fund trustees, insurance company boards, risk committees and other decision makers. The standard on data, which comes into effect in July 2010, aims to ensure that the data on which actuarial information is based is reliable and includes principles on the checking and preparation of data. The BAS will shortly issue a standard on modelling and will promote the reliability and usefulness of actuarial methods.

The BAS will issue standards on pensions and insurance in 2010/11, which will provide further support to those who use actuarial information. The POB will also provide input to the actuarial profession to help it respond to the new framework we have proposed for monitoring actuarial quality and compliance. This will cover both technical standards, which we set, and the ethical and competence standards which are set by the profession.

We are reviewing the effectiveness of the regulatory framework for professional discipline, including the FRC's role within the framework, in the light of the financial crisis and our experience of operating independent disciplinary arrangements for the last five years.

The POB will continue to monitor activities that could adversely affect public confidence in accountants and actuaries and take action where appropriate.

Influencing and responding to international initiatives

The regulatory framework for corporate reporting and governance in the UK is crucially influenced by decisions taken at EU and international level.

Over the last year, the work of the International Accounting Standards Board (IASB) and the European Financial Reporting Advisory Group (EFRAG) has increased as the IASB seeks convergence with US standards. The ASB has responded to over 80 consultations in 2009 – up from 56 the year before. The deadline of 2011 when the US SEC is scheduled to decide on its adoption of IFRS means that the heavy workload will continue.

We will continue to influence the further development of IFRS and its adoption in the EU. We will continue to press for a single set of high quality accounting standards which is accepted globally and is compatible with national Generally Accepted Accounting Principles (GAAPs), including UK GAAP. The ASB is currently seeking the views of UK stakeholders to ensure that there is support for a UK strategy for convergence with international standards, that UK accounting standards reflect market developments, and that the needs of smaller companies are addressed.

We strongly believe that audit quality should be promoted internationally and we will continue to play a leading role in the International Forum of Independent Audit Regulators (IFIAR), and the European Group of Auditors' Oversight Bodies (EGAOB). The APB also participates in the International Auditing and Assurance Standards Board (IAASB).

We will also contribute to the continuing development of the EU Solvency II project.

Enhancing our own effectiveness and efficiency

Our stakeholders are under considerable pressure to keep their costs under tight control. We will continue to seek significant efficiencies in the way we operate, whilst meeting our regulatory obligations and addressing the major issues of concern from shareholders. To deliver an effective programme of activity that meets these increasing obligations and needs will require some expansion in our resources and we are budgeting for an increase of 3% in 2010/11.

Our current government funding is reducing. We expect the Government to cut its contribution to our core operating costs for accounting, auditing and corporate governance by an amount equivalent to a 9.1% reduction in core operating costs. The Department for Business, Innovation and Skills (BIS) will confirm the level of contribution in the first quarter of 2010.

We plan to absorb much of the impact of this reduction in Government support through efficiency savings and by seeking income from new sources. We have budgeted to raise half of the Government cut from existing funding. We will increase by 5% the amount we raise from publicly traded companies through our preparers levy. We also plan to increase by 5% the levies on insurance companies and pension schemes to discharge our responsibilities for actuarial standards and regulation in 2010/11. This reflects the significant potential costs of actuarial disciplinary cases.

Two – Proposed major activities and projects

Proposed major activities and projects in 2010/11

In developing our Plan's major activities and projects, we focus on the risks to confidence in corporate reporting and governance. Our full work programme is extensive. This section reports on just the major activities and projects assessed in relation to each of our four priorities for 2010/11 are as follows:

Helping to address the challenges of current conditions

- The FRC will consider whether there remains a need to issue updated guidance to audit committees and directors about the financial crisis, which focuses on the key issues, and will publish revised guidance if appropriate.
- The AIU will monitor and report on the quality of audits, based on the reviews of some 100 audits, of which the majority will relate to the largest audit firms, focusing on areas of high subjectivity and professional judgement and compliance with ethical standards.
- The FRRP will review a selection of annual and interim accounts and directors' reports for compliance with the Companies Act, including applicable accounting standards. The Panel aims to review around 300 sets of accounts in 2010/11 with a focus on the following industry sectors where there may be a higher risk of non-compliance. Those sectors, as advised by the FRC's Standing Advisory Committee, are commercial property, advertising, recruitment, media and information technology.

Identifying and responding to the longer term lessons of the financial crisis

- The POB will review progress in implementing the recommendations of the Market Participants Group on concentration on the UK audit market and assess the extent to which further action is required.

- The FRC will implement changes to the UK Corporate Governance Code and support the introduction of a stewardship code for institutional investors.
- The BAS will complete its suite of technical actuarial standards, focusing on the needs of users of actuarial information.
- The FRC will promote increased relevance and reduced complexity of corporate reporting on the basis that reporting should be relevant, reliable, intelligible and comparable and be useful for decision-making, including stewardship decisions. The ASB will lead a wide-ranging debate designed to stimulate improvements to narrative reporting, including disclosures in relation to business models.
- The FRC will complete the review of the effectiveness of the framework for professional discipline, including the FRC's role within the framework.
- The APB will explore ways in which the usefulness of information contained in audit reports can be enhanced from the perspective of investors and other users.
- The APB will make any necessary changes to ethical standards resulting from our consultation on audit firms providing non-audit services to firms which they audit.
- The AADB's priority will be to make significant progress on, and where possible to finalise, the matters with which it is currently dealing and to identify and investigate other matters which meet the criteria for AADB investigations.

Influencing and responding to international initiatives

- The ASB will seek to ensure continued support in the EU for maintaining the IASB and other standard setters' ability to exercise independent judgement in setting accounting standards.

- The ASB will take a lead role in influencing the development of IFRS and on the appropriate IASB strategy when convergence with US GAAP ends in 2011. The ASB will also play an active role in promoting the development of a disclosure framework.
- The ASB will take a lead role in UK and global debates about the extent of the use of fair value, including hosting roundtables as necessary, and provide written comments in response to IASB and FASB consultations.
- The POB will demonstrably influence the work of IFIAR and EGAOB to promote effective regulatory oversight of audit firms, including those managed on a regional basis.
- The BAS will keep under review the implications of the introduction of Solvency II.

Enhancing our own effectiveness and efficiency

We believe that the FRC should be effective, accountable and independent:

- The FRC will secure efficiency savings equivalent to 5% of core operating costs.
- The FRC will ensure that appropriate arrangements are in place for managing the financial risks associated with the current disciplinary scheme.
- The FRC will implement an enhanced communication strategy to demonstrate to funding groups that the FRC manages its costs carefully and provides good value for money.
- The FRC will identify, monitor and respond to emerging developments.
- The FRC will review the FRC's overall relationship with the accountancy and actuarial professions.

Consultation Question

1) Do you have any comments on the proposed major activities and projects? Are there any additional activities or projects which should be included?

Three – Draft 2010/11 budget

Our Financial Management and Reporting Framework provides the framework within which we manage and report on the costs of our activities and how they are funded. The framework is available at <http://www.frc.org.uk/about/funding.cfm>.

As noted in the overview, we propose to increase our budgets for core operating costs by 3% compared to 2009/10 and to absorb about half of the reduction in the government funding contribution.

At the time of publication of this document our financial results for 2009/10 remain subject to audit and are, therefore, described as forecasts.

Table 1 summarises our overall budget; Table 2 sets out our expenditure and funding projections for core operating costs in relation to accounting, auditing and corporate

governance; table 3 sets out our expenditure and funding projections for in relation to actuarial standards and regulation; and Table 4 summarises our projected level of reserves.

The costs of audit inspection and accountancy disciplinary cases are met by the professional bodies. Certain categories of costs depend on the number and complexity of cases and cannot be subject to firm budgetary limits: these are indicated by an asterisk.

Table 1 – Budget Summary

	Draft Budget 2010/11 £m	Forecast 2009/10 £m	Budget 2009/10 £m
Accounting, auditing and corporate governance			
Core operating costs	12.9	12.2	12.5
Audit inspection costs	2.6	2.4	2.6
Accountancy disciplinary costs	2.9	2.4	1.8
Total	18.4	17.0	16.9
Actuarial standards and regulation	2.9	2.8	2.6
FRC Total costs	21.3	19.8	19.5

Table 2 – Expenditure and funding projections - Accounting, auditing and corporate governance

	Draft Budget 2010/11 £m	Forecast 2009/10 £m	Budget 2009/10 £m
Core operating costs	12.9	12.2	12.5
Review Panel case costs*	—	—	—
Increase/(decrease) in reserves	<u>—</u>	<u>1.0</u>	<u>0.3</u>
Total requirement	12.9	13.2	12.8
<i>Funded by:</i>			
<i>Preparers levy – Publicly traded companies</i>	4.7	4.5	4.5
<i>Preparers levy – Large private companies</i>	1.8	1.4	1.0
<i>Preparers levy – Public sector organisations</i>	0.5	0.5	0.5
<i>Accountancy professional bodies</i>	4.7	4.5	4.5
<i>Government</i>	<u>1.2</u>	<u>2.3</u>	<u>2.3</u>
Total	<u>12.9</u>	<u>13.2</u>	<u>12.8</u>

Table 3 – Expenditure and funding projections – Actuarial standards and regulation core operating costs

	Draft Budget 2010/11 £m	Forecast 2009/10 £m	Budget 2009/10 £m
Core operating costs	2.4	2.2	2.3
Actuarial disciplinary case costs*	0.6	0.4	0.5
Increase/(decrease) in reserves	(0.1)	0.1	-
Increase/(decrease) in actuarial case costs fund	<u>-</u>	<u>0.1</u>	<u>(0.2)</u>
Total costs	2.9	2.8	2.6
<i>Funded by:</i>			
<i>Actuarial profession</i>	0.3	0.2	0.2
<i>Insurance levy</i>	1.3	1.3	1.2
<i>Pension levy</i>	<u>1.3</u>	<u>1.3</u>	<u>1.2</u>
Total	<u>2.9</u>	<u>2.8</u>	<u>2.6</u>

Table 4 - Projected level of reserves at 31 March

<i>Reserves</i>	Draft Budget 2011	Forecast 2010	Actual 2009
	£m	£m	£m
FRRP Legal cost fund	2.0	2.0	2.0
Accounting, auditing and corporate governance – general	1.9	1.9	0.9
Actuarial case cost fund	0.6	0.6	0.5
Actuarial standards and regulation – general	<u>0.1</u>	<u>0.2</u>	<u>0.1</u>
FRC total reserves	<u>4.6</u>	<u>4.7</u>	<u>3.5</u>

Our intention is to maintain our reserves at an appropriate level. We consulted on the level of our reserves in relation to accounting, auditing and corporate governance in 2008 and concluded that it would be prudent to increase the level of our general reserves following the significant reduction in Government funding.

Consultation Question

2) Do you have any comments on our draft budget and our funding projects for 2010/11?

Four – 2010/11 levy proposals

Accounting, auditing and corporate governance

Preparers levy

The levy applies to publicly traded companies, large private entities and public sector organisations and is also used to raise the UK contribution to the IASB. The amounts we propose to raise from each group in relation to the FRC's funding requirement and the IASB are as follows.

	FRC requirement		plus	IASB contribution		=	Preparers levy		%
	2010/11 Budget	2009/10 Budget		2010/11	2009/10		2010/11	2009/10	
	£m	£m		£m	£m		£m	£m	
Preparers of financial statements:									
Publicly traded companies:	4.7	4.5		0.6	0.6		5.3	5.1	5%
Large private entities	1.8	1.0		0.2	0.1		2.0	1.1	n/a
Public sector organisations	0.5	0.5		0.1	0.1		0.6	0.6	5%
Total	7.0	6.0		0.9	0.8		7.9	6.8	16%

The key features of the preparers levy are a minimum levy and further amounts payable by entities above a certain size, with the rate per £m declining in five levy size bands. Details of the application of the levy are published on our website: <http://www.frc.org.uk/about/funding.cfm>.

The minimum levy is 5% higher than 2009/10. We estimate that those publicly traded companies which paid the levy in 2009/10 will pay, on average, 5% more in cash terms than in 2009/10, although there is a potentially wide range of increases or decreases for individual companies. We will write to each entity which is subject to the preparers levy to explain the implications of the proposed levy rates for that entity and announce the finalised rates and the discounts which will apply to certain categories of levy payers in May 2010.

For 2010/11 we will apply the levy to private entities with a turnover of £500m or more in line with the proposals on which we consulted in 2008.

Proposed preparers levy rates for 2010/11

To allow organisations to estimate the likely amount of the levy we have calculated provisional rates as follows:

Band	Organisation size *£m	Proposed 2010/11 levy per £m*	2009/10 levy rate per £m*
1 Minimum levy	Up to 100m	Min levy £1030	Min levy £980
2	100m-250m	£8.83	£9.39
3	250m-1,000m	£6.74	£7.17
4	1,000m-5,000m	£4.81	£5.12
5	5,000m-25,000m	£0.08	£0.0853
6	>25,000m	£0.016	£ 0.0171

**Size is either based on market capitalisation, published turnover, or overall expenditure depending on the type of organisation.*

Actuarial standards and regulation

Insurance levy

The insurance levy will be allocated to insurance companies in the same proportion as the FSA regulatory fees and charged to insurance companies on the same invoice as the FSA fees. In 2009/10 we applied a levy equivalent to 1.7% of the FSA regulatory fees. Although we will not be in a position to finalise the levy rate until the FSA confirm its rates for the relevant Fee-blocks, we expect to increase the average levy paid by insurance companies in 2010/11 by an average of 5%.

Pension levy

The pension levy will be allocated to schemes on the basis of their latest scheme returns to the Pensions Regulator. We will not be in a position to finalise the pension levy rate until the Pensions Regulator has confirmed the necessary data on scheme membership. Based on the data currently available we expect to apply a levy of £3.15 per 100 members with a minimum levy of £31.50, an increase of 5% compared to 2009/10.

Consultation Question

3) Do you have any comments on our levies for 2010/11?

Five - contact details

Responses to the Draft Plan 2010/11 should be sent, by 10 March 2010, to:

Policy and Planning Manager

Financial Reporting Council

5th Floor, Aldwych House

71-91 Aldwych

London

WC2B 4HN

e-mail: planning@frc.org.uk

Telephone: 020 7492 2300

Fax: 020 7492 2301

Unless respondents indicate otherwise, we will publish responses on our website.

For general information about the work of the FRC, please see our website at www.frc.org.uk. For any further enquiries, please contact us at the above address.



Financial Reporting Council

5th Floor

Aldwych House

71-91 Aldwych

London WC2B 4HN

Tel: +44 (0)20 7492 2300

fax: +44 (0)20 7492 2301

Website: www.frc.org.uk

© The Financial Reporting Council Limited 2009

The Financial Reporting Council Limited is a company limited by guarantee. Registered in England number 2486368.
Registered Office: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.