FRC

Financial Reporting Council

Levy Proposals 2006/07

March 2006

Introduction

This paper explains the Financial Reporting Council's (FRC) proposal for our levy on listed companies for 2006/07. The proposal is that the levy rates per £m of capitalisation for 2006/07 should be 10% lower than those for which applied in 2005/06. Responses to the proposal are invited by 28 April 2006.

We are consulting separately on proposals for funding our planned new responsibilities for actuarial standards and regulation.

Background

The FRC is the United Kingdom's independent regulator for corporate reporting and governance. We were established in 1990. Following reviews of the existing regime which were undertaken in 2002, the Government significantly expanded the scope of our responsibilities and powers from 1 April 2004.

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

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.

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

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

The functions which we exercise in pursuit of our 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.

Our functions are exercised by our operating bodies (the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Professional Oversight Board for Accountancy (POBA), the Financial Reporting Review Panel (FRRP) and the Accountancy Investigation and Discipline Board (AIDB)) and by our Council.

Some of our functions are supported by statutory powers, or by statutory obligations on other parties to meet our requirements. Some of our functions have no statutory backing but derive their authority from widespread support from our stakeholders.

Most our activities affect all companies in the UK which are required to prepare accounts under the Companies Act, although some activities (primarily our work on corporate governance) apply only to listed companies. As a consequence of the Companies (Audit, Investigations and Community Enterprise) Act 2004, with effect from April 2005 non-UK companies whose equity shares have their primary listing in the UK came within the scope of our activities.

From April 2006, it is intended that we will assume responsibility for actuarial standards and regulation as recommended by the Review of the Actuarial Profession conducted by Sir Derek Morris. At the time of finalisation of this document we are still consulting on and finalising various aspects of the implementation of our new responsibilities.

Further information on our approach to our work and our governance and accountability are set out in our Regulatory Strategy which is available on our website: http://www.frc.org.uk/about/.

The FRC's funding arrangements

For many years our core operating costs have been funded in equal proportions by the accountancy profession, the business community and the government. This is known as the tri-partite funding arrangement. Certain other costs (eg of audit inspection, and the investigation and discipline of accountants) are funded entirely by the accountancy profession.

We are a non-profit making organisation. Our intention in raising funds is merely to recover our costs and to ensure that we have an appropriate level of reserves.

The business community's share of our operating costs is raised by means of a levy on UK companies listed on the LSE's main market, which is collected on our behalf by the Financial Services Authority (FSA) at the same time as the FSA invoices listed companies for their Listing Fees.

This arrangement means that the incremental cost of collecting our levy is very low. We, not the FSA, are accountable for the amount of the levy and the amount of our levy is shown separately on the invoices.

We implemented a market capitalisation based levy in 2005/06. The key features of the levy are:

- a minimum levy payable by all listed companies
- further amounts payable by companies above a certain market capitalisation, with the rate per £m of market capitalisation declining in five levy size bands.

The minimum levy and the rates for larger companies are calculated based on the number of UK listed companies and their market capitalisations as at 30 November in the year preceding the year to which the levy relates (ie the levy for 2006/07 is based on data as at 30 November 2005). This date is the one on which the LSE and the FSA base their fees; adopting this date avoids the need for additional data collection and inconsistency with their fee calculations.

The amounts payable by companies of any given size will be determined by the decisions on:

- the amount of the minimum levy
- he size limit for companies to which only the minimum levy applies
- the speed at which the rates payable by larger companies decline

Our levy is payable by UK companies and by non-UK companies whose equity shares have their primary listing in the UK, which come within the scope of most of our activities. In recognition that not all of our activities affect non-UK companies, we apply a discount of 50% to the levy payable by non-UK companies.

We currently raise our levy on a non-statutory basis based on the widespread support in the business, investor and professional communities for our work. There is provision in the Companies Acts for the Department of Trade & Industry (DTI) to make our levy a statutory charge. It is not the desire of either the FRC or the DTI to invoke those powers as the non-statutory arrangements have worked successfully and flexibly since 1990. However, should the non-statutory arrangements not prove to be sustainable then use of the statutory powers would need to be considered.

The FRC's budget for 2006/07

The FRC is very conscious that 2006, like 2005, is a year of major change for many companies, their shareholders and auditors. In these circumstances we are not proposing any significant new burdens on companies and their auditors for 2006/07. An important feature of our work in 2006/07 will be taking an active role in helping to shape policy proposals affecting corporate reporting and governance in the UK which are initiated by the EU and other international organisations. We will seek to ensure that, as far as possible, these proposals contribute to confidence in corporate reporting and governance, are proportionate to the issues they address, and do not impose unnecessary burdens.

Our budget for core operating costs in 2006/07 (£10.5m) is an increase of 2% compared to our budget for 2005/06 but flat in real terms. A delay in reaching our target staffing level means that we now expect to spend £9.3m on core operating costs in 2005/06 compared to the budget of £10.3m. The budget for 2006/07 represents an increase of 13% over the forecast for 2005/06.

Further details of our priorities for 2006/07 and the costs which we expect to incur are set out in our Plan & Budget which can be found on our website: http://www.frc.org.uk/about/.

The amount of the business levy for 2006/07

The business community's share of our core operating costs for 2006/07 is £3.5m.

However, we have forecast that the amount collected from the business levy in 2005/06 will exceed the business community's share of the costs for 2005/06 by £0.2m. We propose to offset this amount against the business levy for 2006/07. As a result the amount which we need to raise from the business community in 2006/07 is projected to be £3.3m, which is very similar to the amount raised in 2005/06.

Proposed levy rates for 2006/07

In the period between November 2004 and November 2005 there has been a significant increase in the market capitalisation of listed companies. Given that the amount which we aim to raise is very similar to that raised in 2005/06 we are able to propose rates per £m of market capitalisation for 2006/07 which are approximately 10% lower than those in 2005/06.

The final rates which will apply for 2006/07 can only be determined after 1 April when the number of companies which will be liable to pay the levy is finalised. In order to allow companies to estimate the likely amount of the levy we have calculated provisional rates as follows:

Band	Market capitalisation (£m)	Levy rate per £m of market capitalisation 2006/07 proposed (£)*	Levy rate per £m of market capitalisation 2005/06 actual (£)*
1	Up to 100	Min levy £800	Min levy £800
2	100 - 250	5.00	5.50
3	250 - 1,000	3.80	4.25
4	1,000 - 5,000	2.70	3.00
5	5,000 - 25,000	0.045	0.05
6	> 25,000	0.009	0.01

** non-UK companies will receive a discount of 50%*

The proposed market capitalisation bands are identical to those implemented by the FSA for its UKLA fees and are unchanged from 2005/06, which will reduce the costs of collecting our levy. The proposed minimum levy and the rates in the other bands differ from those proposed by the FSA because the number of companies which are liable to pay our levy differs from those who pay the UKLA fees and our costs are also different.

The following example illustrates the way in which the 2006/07 levy will be calculated for a UK company with a value of £350m:

Market capitalisation band (£m)	Levy calculation	Levy payable (£)
Up to 100	Min levy	800
100 - 250	150 x 5.00	750
250 - 1,000	100 x 3.80	380
		Total 1,930

The 2005/06 levy for a company with a market capitalisation of £350m was £2,050.

We will announce the final rates payable in June 2006.

Consultation question:

Do you agree with our proposed levy rates for 2006/07?

Actuarial standards and regulation

From April 2006 it is intended that we will assume responsibility for actuarial standards and regulation as recommended by the Review of the Actuarial Profession conducted by Sir Derek Morris, whose recommendations have been accepted in principle by the Government. At the time of finalisation of our 2006/07 Plan & Budget we were still consulting on and finalising various aspects of the implementation of these new responsibilities.

We have proposed to introduce separate funding arrangements for our planned new responsibilities for actuarial standards and regulation. We have proposed that our new responsibilities will be funded by the actuarial profession, insurance companies and the pension industry. There will be no cross-subsidy between our new responsibilities and our existing responsibilities for accounting, auditing and corporate governance, although our actuarial costs will include a fair share of our overheads.

If our new responsibilities for actuarial standards and regulation are implemented as planned then the costs of those activities will include a fair share of our support services and corporate costs, which we estimate to be £0.3m. This would reduce our budget for core operating costs in 2006/07 to £10.2m and the amount which we would need to raise from the business community would be reduced to £3.2m. There will be a corresponding reduction in our levy from the amounts proposed in this paper.

The extension of the levy to other publicly traded companies

When the FRC was first established the London Stock Exchange's Main Market was the only forum for public trading in companies' shares. The position is now different with AIM now trading shares in significant numbers and values of companies and Ofex also having a primary market offering. The competitive landscape for exchanges continues to evolve and it is possible that other markets may emerge in the future.

AIM

AIM was created in 1995 by the London Stock Exchange plc. Although the regulatory regime for AIM is lighter touch than the Main Market, which is regulated by the FSA, companies quoted on AIM are subject to the disciplines associated with being publicly traded and are subject to public scrutiny of their performance. There are currently over 1,400 companies quoted on AIM with a total market capitalisation of around £62bn.

Specifically in relation to our responsibilities, AIM companies and their auditors are subject to the accounting and auditing standards which we set, monitor and enforce. The only significant aspect of our work which does not apply to AIM companies is our work on preparations for implementing the requirements of the 8th Company Law Directive relating to the registration and inspection of overseas auditors and the Combined Code on Corporate Governance (which accounts for less than 5% of our costs).

AIM has experienced particularly significant growth in the last two years. During this period the number of companies on the Main Market has declined.

The point has now been reached where the amount of our costs which can be fairly attributed to AIM is not de-minimis, but the business community's share of those costs is being met by a declining number of listed companies. There is, therefore, a degree of cross-subsidisation between on the one hand the Main Market and AIM on the other which we believe is no longer defensible.

Looking to the future the position would become worse were the recent trends of numbers of companies on the two markets to continue.

In 2005 we therefore proposed that our levy should be extended to include AIM companies. In order to reflect the fact that AIM companies have lower regulatory costs than the Main Market, we proposed that they would receive a discount of 25% on their levy compared to companies on the Main Market. The market capitalisation bands would mean that the vast majority of AIM companies would have paid only the minimum levy.

Ofex

The Ofex market, which was created in 1995, is regulated, operated and promoted by Plus Markets Group plc as an independent public market specialising in small and medium enterprises. It is intended to create all the benefits of being traded on a public market but within a regulatory environment designed specifically for smaller companies.

There are currently approximately 160 companies listed on the Ofex market, with a total market capitalisation of £1.9bn.

In 2005 we proposed that our levy should be extended to include Ofex companies on the basis that they were subject to Companies Act reporting requirements and derived benefits from our work. In order to reflect the fact that Ofex companies are not subject to the full range of the FRC's regulatory regime, we proposed that they would receive a discount of 25% on their levy compared to companies on the Main Market. The market capitalisation bands would mean that the vast majority of Ofex companies would have paid only the minimum levy.

FRC views

The extension of the levy to AIM and Ofex was not intended to generate additional income for us: we would have continued to operate within our published budgetary limits. The purpose was to ensure a fairer distribution of those costs across the business community. If AIM and Ofex companies were to be included within the levy then the FRC would be able to set the minimum levy and rates for larger companies which would be lower than would otherwise be the case.

However, those proposals did not command the support of the London Stock Exchange in relation to AIM or Plus Markets Group plc in relation to the Ofex market.

We have not repeated our proposal for 2006/07 but we will continue to keep the position under review and would welcome feedback on this issue.

Contact Details

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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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