Consultation

Financial Reporting Council

March 2019

Draft Plan and Budget 2019/20

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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One – Our strategic priorities

This will be a year of transition for the FRC. In response to the recommendations of Sir John Kingman's Independent Review[1], the Department of Business, Energy and Industrial Strategy (BEIS) is consulting on proposals to replace the FRC in its current form with a new statutory regulator[2]. The Government's intention is that we will transition into the new authority, to be called the Audit, Reporting and Governance Authority (ARGA), which will be accountable to Parliament, with a new mandate, new clarity of mission, new leadership and new powers.

We strongly share the Government's view that high quality audit, corporate governance and financial reporting are vital to the success of continued growth of the UK economy; and that the confidence that shareholders, employees, investors and the wider public can place in company reports and audited accounts is dependent in part on the effectiveness of the regulatory framework.

We recognise the need for change and believe the speedy implementation of the recommendations of the Independent Review can help increase public confidence in audit, reporting and governance in the UK. While legislation will be needed to establish ARGA, we will be working with Government as a priority to take forward those aspects of the transition that can be undertaken or initiated in advance of the legislation. We have already set in hand measures to strengthen our supervisory and enforcement work.

Our strategic priorities for 2019/20 are as follows. We hope that a diverse range of organisations and individuals will respond to the Government's consultation on major, long-term reforms to the regulatory framework, and to this consultation on our plan and budget for 2019/20.

1 – Support the transition to the new ARGA

We are amending the FRC's Articles of Association to specify that, pending the creation of the new authority, all new appointments to the FRC's Board, including the Chief Executive Officer, will be made by the Secretary of State.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

[2] https://www.gov.uk/government/consultations/independent-review-of-the-financial-reporting-council-consultation-on-recommendations

The Government have asked us to make some immediate changes, which we support, to the scope of our regulatory procedures, to be introduced ahead of the proposed legislation to establish ARGA. These include expanding our work on the quality of that part of an audit conducted overseas, commencing extending the scope of our reviews of corporate reports to cover the whole annual report, and broadening our work on oversight of the accountancy profession.

The Government have also asked us to consult on some specific changes to the regulatory framework that do not require legislation, with a view to making the changes following consultation and during the transition to ARGA. These include whether we should reclaim the approval and registration of audit firms conducting public interest audits, and the sanctions that should be applied under a new, centralised approval and registration regime.

As recommended by the Independent Review, we are taking forward the recommendation to introduce a robust market intelligence function; and will begin a wider and deeper dialogue with UK investors, building on our present consultative arrangements with our Investor Advisory Group.

As an organisation we will invest in the staff and supporting IT and other systems necessary to deliver our regulatory responsibilities effectively while managing the transition to the new authority.

In line with recommendations of the Independent Review, we are preparing voluntarily to apply Freedom of Information provisions to all our work prior to formal designation as a public authority, adopt new procedures on conflicts of interests and procurement, and institute new arrangements for handling and reporting on complaints.

The BEIS consultation document raises further important questions about the future scope of ARGA's regulatory responsibilities. We will support BEIS in considering the policy and practical aspects of the proposed new powers.

2 - Use our powers to set audit standards and monitor and supervise auditors to drive a step change in audit quality

Confidence in audit has fallen. As our audit quality reviews and enforcement cases have shown, the audit profession has not delivered consistently high-quality auditing. There have been a number of high-profile business collapses in which the role of the auditor has been proven inadequate or has been called into question. Our expectations and target for audit quality have not been met. Securing a major improvement in audit quality is, therefore, a leading objective for the coming year.

Through our Audit Firm Monitoring and Supervisory Approach (AFMAS) we will focus on the quality and accountability of the leadership of the largest audit firms and their ability to create the right culture to support consistently high-quality audit. We have started a major new programme of work on audit standards, including a comprehensive review of the impact of the new auditing and ethical standards introduced in 2016, and have proposed a new standard on the audit of companies' going concern statements. We will complete this work in 2019/20, while at the same time enhancing our programme of audit quality inspections. We will also discuss with investors how best to take forward the Independent Review's recommendations of transparency of audit inspection results.

We will contribute to, and coordinate with, Sir Donald Brydon's Review of the scope and purpose of audit and, if necessary, prepare to extend our role in the light of its recommendations. We will similarly contribute to the Competition and Markets Authority (CMA)'s ongoing work on the audit market.

3 - Monitor and take action to promote the quality and usefulness of corporate reporting

We are increasing the planned number of corporate reporting reviews we will undertake, concentrating on the main issues that we believe boards and preparers need to address. We will also work to address the Independent Review's recommendations on the impact and visibility of this work, and that it should cover the whole of a company's annual report.

We are taking forward the major project on the future of corporate reporting we launched in 2018. We aim to challenge existing thinking about corporate reporting and consider how companies could better meet the information needs of shareholders and other stakeholders. We are reviewing current financial and non-financial reporting practices, focusing on the fundamental purpose of, and public interest in, corporate reporting and the annual report; and considering what information investors and other stakeholders require. This work too will in part contribute to Sir Donald Brydon's Review.

4 - Promote corporate governance and investor stewardship that contribute to trust in business

The new UK Corporate Governance Code we introduced in 2018 was well received. As an important part of our work in 2019/20 we will extend our monitoring of practice and reporting on corporate governance and how effectively companies are implementing the new Code.

The effectiveness of our corporate governance regime depends on investors holding companies to account. We are consulting on a revised UK Stewardship Code which aims to increase demand for more effective stewardship and investment decision-making which is better aligned to the needs of institutional investors' clients and beneficiaries and the broader public interest. The Code currently under consultation sets out more rigorous reporting requirements and focuses on the outcomes of stewardship activities. The FRC will ensure that only those who demonstrate their commitment to the expectations of the new 2019 Code can be signatories.

In its consultation on the Independent Review, the Government refers to the recommendation that it should consider adopting a strengthened framework around internal controls similar to the Sarbanes-Oxley regime in the United States. It notes that this is a detailed and complicated issue, and that it will explore options in this area and bring forward a detailed consultation in due course.

We will be consulting on enhancing Viability Statements and our guidance on Risk Management and Internal Controls. This will be undertaken in a manner that can be built upon following the Government's consultation on the Independent Review.

5 - Use our enforcement powers effectively

The FRC has invested significantly in its enforcement work and will continue to do so. The public interest requires that serious shortcomings by those we regulate are addressed and sanctioned as quickly as the necessary procedures and principles of natural justice will allow. Our Audit Enforcement Procedure provides that a greater range of breaches of relevant requirements of varying degrees of seriousness are potentially capable of being sanctioned. Our investment in this area has enabled us to complete more cases more quickly and to hold firms and individuals effectively to account.

We will continue to invest in our Enforcement Team - maintaining a strong deterrent to poor behaviour through the cases we pursue and the outcomes we secure, and by promulgating the lessons from the failings in those cases.

6 - Ensure an effective regulatory framework following EU Exit

Following EU exit, a key step will be the smooth transition to a new UK regime for decisions on the endorsement of International Financial Reporting Standards (IFRSs) for use in the UK. The Secretary of State will appoint the chair of a new Endorsement Board (EB). The EB will be accountable to the Secretary of State for its decisions. The FRC Board will be responsible for ensuring that it follows due process.

On EU exit, the UK will become a ‘third country’ in the context of EU legislation and EU countries will be ‘third countries’ in UK legislation. We are, therefore, adding capacity to enable us to assess and register EU auditors of entities listed in the UK. We will handle applications for audit equivalence in accordance with whatever EU exit implementation and transition arrangements are in place; and will continue to process annual renewals and new applications for registration by non-EU third country auditors. We will also prepare the necessary and important UK application to the EU for equivalence and adequacy for UK audit firms. Our aim will be to continue to work effectively with EU regulatory authorities and more widely internationally.

Our expenditure and funding

To implement our 2019/20 plan as set out in Section Two we have proposed a budget of £38.1m to fund recruitment of 80 additional staff. This is an increase of 11% compared to our expected 2018/19 outturn (£34.4m). The planned increases in 2019/20 in part reflect a catch-up for recruitment delays in a highly competitive market in 2018/19. They will provide for our expanded activities to pursue a step change in audit quality, strengthen enforcement, and promote the quality of corporate reporting, governance and investor stewardship.

This budget does not include the costs of implementing those recommendations of the Independent Review that do not require new legislation, or additional costs related to EU exit – costs that we cannot yet accurately forecast. Given the uncertainties, we have indicated a range of £2.4 million to £4.9 million for the possible additional expenditure beyond the £38.1m budget. We will agree with BEIS how the additional resources should be secured.

We will continue to fund our work through annual contributions from market participants, some of which are collected as non-statutory levies, and by recovering the cost of audit and accountancy enforcement cases from the professional bodies. We do not receive a Government grant, but we have the benefit of formal assurances from Government that, if we are unable to recover our costs through our current funding arrangements, it will put in place fully statutory arrangements. In the light of these assurances, we will not allocate additional resources to the general reserves we have built up to mitigate the risk of a shortfall in the amounts we collect through our voluntary levies or from any unexpected costs arising from our enforcement activities. These reserves fall within the guidance set out in Managing Public Money and can, therefore, only be deployed with Government consent.

Responding to the consultation

The BEIS consultation on its response to the recommendations of the Independent Review of the FRC closes on 11 June 2019. We would welcome comments on our Draft Plan and Budget for 2019/20 by 8 May 2019. In delivering our Plan we will take account of the response to the BEIS consultation and will continue to consult stakeholders on our major projects and on changes to our policies and procedures.

Sir Winfried Bischoff **Chairman**	**Stephen Haddrill** **Chief Executive**

Two - Our Plan for 2019/20

The Independent Review supported a number of the initiatives we have taken as part of our Strategy for 2019/21 to help rebuild trust in business through good governance, reporting and auditing.

During 2018/19 we have made significant progress in delivering those initiatives, on which we consulted stakeholders in developing our Strategy. We have:

- Established our Audit Firm Monitoring and Supervisory Approach (AFMAS) to support our aim of driving up audit quality.
- Concluded a number of significant enforcement cases.
- Launched major projects to consider the future of audit and corporate reporting.
- Played our part in ensuring that EU exit is implemented effectively in relation to audit and accounting matters and continued to work closely with regulators in other jurisdictions.
- Consulted on and published the new UK Corporate Governance Code, which came into effect on 1 January 2019.
- Proposed a revised Stewardship Code to encourage more effective stewardship by institutional investors.
- Worked with leading industrialist, James Wates, to create a set of corporate governance principles for large private companies.

This section sets out the projects and activities we propose to deliver in 2019/20. In finalising our plan, we will take account of developments in relation to EU exit, and the Government's consultation following the Independent Review.

During the year, alongside our reports and consultations on specific issues, we will publish our annual findings on UK auditing, corporate reporting, corporate governance and investor stewardship and a report on our enforcement work.

Audit and assurance

As the competent authority for statutory audit in the UK we will take the following actions in 2019/20:

Audit and ethical standards

We have issued a position paper which sets out how Ethical and Auditing Standards will be developed to respond better to the needs of users of audited financial information, following the recent call for feedback on the 2016 auditing and ethical standards. The paper sets out the issues that will be developed to support a public consultation on the text of revised standards over the summer of 2019. It also sets out how the FRC's work on the standards responds to the recommendations of the Independent Review of the FRC, how proposals are being developed to support the CMA study of the UK Statutory Audit Market; and how revisions made to the international Code of Ethics will be incorporated into the FRC Ethical Standard

We have issued for consultation a revised Going Concern Standard. Going concern is one of the fundamental principles in the preparation of financial statements. Some recent collapses of large companies have brought into question why such companies had clean auditors' opinions that included no warnings that the companies were at risk of collapse. Some enforcement cases conducted by the FRC also found issues related to going concern, raising further concerns about the effectiveness of auditors' work on going concern.

Our revised Standard proposes: greater effort on the part of the auditor to challenge robustly management's assessment of going concern; improved transparency with a new reporting requirement for the auditor to expressly state their conclusions on whether management's assessment is appropriate; and a stand-back requirement to consider all the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern. Subject to consultation the new standard will apply to the audit of financial periods beginning on or after 15 December 2019.

Monitoring audit quality

Supported by BEIS in their consultation, the FRC will take forward the recommendations of the Independent Review on audit quality reporting in 2019/20.

Over the past five years we have expanded the total number of audits inspected from 126 (2014/15) to approximately 160 in 2018/19. We will continue this expansion going forward, but we are also looking to broaden the breadth and depth of our work on each of the audit inspections that we carry out. Expanding the number of reviews that we complete and the depth to which they go will enhance our ability to hold audit firms to account for the quality of their work. Delivering this expanded programme of work, however, will be dependent upon our success in recruiting additional staff to the team, both to fill existing vacancies and then to grow the team over time.

We construct our programme of inspections to include reviews of audits of companies in priority sectors - those where we consider both audit risks and risks to companies themselves to be most pronounced. For 2019/20, these sectors are: financial services, with emphasis on banks, other lenders and insurers; general retailers and retail property; business support services; and construction and materials.

In our individual inspections, we consider both the key audit risks that the auditor has identified, emerging risks identified from our broader market intelligence, and areas where we have in the past seen particular risks to quality or deficiencies. For 2019/20, these areas are: long-term contracts; the impairment of non-financial assets; going concern and the viability statement; and the work the auditor carries out on the information in the annual report outside the financial statements.

We will consider also the potential impact of the EU exit on companies, in both the selection of audits to review, and the individual areas of audit work to focus on.

Beyond our individual audit inspections, which focus on the quality of auditing, our work will involve closer monitoring of developments in policies, procedures and processes at a firm-wide level. We will also undertake thematic reviews. These seek to improve audit quality by benchmarking developments in audit practices across the major firms. This year, our firm-wide work will focus on processes in two areas: appraisals, remuneration, promotion and other HR procedures; and client acceptance and continuance controls.

We will continue to supplement our monitoring programme with thematic reviews of certain aspects of audits where there is scope for improvement and learning from good practice. The topics for 2019/20 are:

- Audit Quality Indicators (AQIs): An assessment of the development and use of AQIs by UK audit firms and their global networks. This review has been held over from our 2018/19 inspection programme.
- The use of technology in audits. We last reported on firms’ use of data analytics in January 2017.We will revisit the progress that the firms have made since, how the use of technology has widened beyond data analytics and the impact upon audit quality.

In 2019/20, the FRC will take forward the recommendation of the Independent Review that we should publish anonymised reports on our inspections. The Government will work with the

FRC to develop an appropriate way forward for publishing the full reports. The BEIS consultation document notes that careful consideration will be needed to ensure that information published appropriately respects confidentiality, personal data and market sensitivity restrictions.

The FRC will also take forward in 2019/20 the recommendation to change our approach to examining the quality of component audit work conducted overseas, on a risk-based basis.

Audit Firm Monitoring and Supervisory Approach (AFMAS)

In last year's plan, we announced the introduction of a new approach to the monitoring and supervision of the largest audit firms - the Big Six firms - which are particularly core to the integrity and transparency of our capital markets.

As part of this work, we will set out our expectations of each firm and seek evidence in five areas: leadership and governance; values and behaviours; business models and financial soundness; risk management and control; and evidence on audit quality, including from our programme of audit quality reviews. We will summarise our findings across the firms in our annual report on 'Developments in Audit'.

The Independent Review welcomed this approach. We are recruiting staff with the necessary skills and experience, in a competitive market, and plan to make a significant impact in 2019/20. For the longer term, placing the AFMAS function on a statutory footing will require legislation, which the Government plan to bring forward as soon as Parliamentary time allows.

Monitoring and mitigating risks to the audit market

The FRC has responsibility for the regular monitoring and mitigation of risks in the audit market. These include the risks of systemic deficiencies within an audit firm network which could lead to the demise of that firm and have an impact on the overall stability of the financial sector.

We have issued, and subsequently enhanced, the Audit Firm Governance Code in order to secure enhancements to the quality of governance and ensure that risks to the firms are managed in the public interest. The Code applies to firms that audit 20 or more listed companies but may also be adopted on a voluntary basis by firms auditing fewer than that.

The level of concentration in the UK market, and the reliance on the four largest firms, required us to develop and strengthen our regulatory approach because, if realised, the risks of a UK firm failing would have a grave impact on the market should a firm be unable to provide audit services.

In addition to AFMAS, we have undertaken enhanced monitoring work in two areas - contingency planning, and information security.

For contingency planning, we focused on how the firms' audit practices would respond to extreme and challenging scenarios. In an extreme scenario, we examined firms' plans where recovery is not achievable, to determine the impact this might have on financial markets, and how this might be minimised. This area of 'resolution' planning is one where more work is required. We expect firms to consider how audit services can be delivered to entities that they audit where a firm's existence in the UK is under threat. Planning for the continuance of audit services is necessary to avoid disruption to capital markets, and 'resolution' plans are crucial in this respect.

Information security, including IT and cyber risks, is an increasingly important topic for audit firms. In 2018 we reviewed UK firms' risk management policies and procedures over information security, using a maturity framework based on recognised standards, to benchmark the firms. We provided feedback based on the information security risks affecting the firms, including areas for improvement.

In 2019/20 we will build on the work we undertook in 2018/19 on audit firm contingency planning and information security. We have asked for progress reports from the firms on the actions they have taken to meet our concerns.

Global and international regulatory cooperation

We work with fellow regulatory authorities from around the world, as a member of the International Forum of Independent Audit Regulators (IFIAR), to hold the global networks to account for their work on audit quality.

The largest audit firms are systemically important institutions: issues in one part of a firm's global network can affect the UK firm's reputation. The FRC, like other audit regulators, has no authority over the audit firms' global networks. However, UK audits frequently rely on the quality of work overseas. The international networks of the firms must ensure that public interest entity audits are completed to the highest standards by all national firms.

As part of our work to influence international developments that support our regulatory responsibilities for audit, we will continue to support the development of, consultation on, and adoption of revised international auditing standards by the International Audit and Assurance

Standards Board (IAASB) that can be used to hold global as well as local leadership to account.

Audit quality

As the competent authority for statutory audit in the UK, the FRC delegates regulatory tasks to the ‘recognised supervisory bodies’ (the RSBs) who play a key role within the audit regulatory framework. In 2019/20 we will monitor audit quality against the key performance indicators (KPIs) agreed with the RSBs. This will enable us to embed a consistent view of audit quality monitoring going forward, and to test the appropriateness of the KPIs. In particular we will follow up on the RSBs’ actions to improve the effectiveness of procedures to identify and mitigate the risks of poor work being repeated, including the application of sanctions procedures and the practice of imposing conditions on renewal of registration, following poor monitoring results.

At the request of BEIS, during 2019/20 we will be consulting on whether we should continue to delegate to the RSBs the approval and registration of auditors of public interest entities, and the shape of any future arrangements.

We will assess the effectiveness of the ‘recognised qualifying bodies’ (the RQBs) in ensuring their qualifications keep pace with developments in technology and the expectations on auditors to act in the public interest. Assessment of the annual returns from each qualifying body will be further informed and validated through our annual on-site monitoring visits to each RQB and regular update meetings.

Mutual recognition of qualifications benefits both those holding audit qualifications in the UK and overseas, and the public interest by providing access to the best skills available in the auditing profession, mobility and experience to help professionals develop and international cooperation and collaboration to serve global capital markets. As the UK exits the EU, we stand ready to respond to support requests from RSBs seeking mutual recognition agreements with similar bodies in other countries. Such agreements cover audit rights and approving third country qualifications, as well as membership and practising rights.

Registration of third country auditors

We will continue to maintain the register of firms and individuals authorised to be Third Country Auditors (TCAs) and our programme of periodic inspections of individual audits completed by registered TCAs.

On EU exit, we will expand our registration and inspection activities and review with the EU and other countries an equivalence regime for the registration of auditors.

Local audit

In 2019/20 both local authority and health bodies will for the first time be covered by FRC monitoring arrangements under the Local Audit & Accountability Act 2014. We are building up our team of inspectors to undertake more reviews in this area. We are currently assessing how our process for local government audit inspections should be different from our reporting and transparency for statutory audits, including how we liaise with audit committees.

The Independent Review made recommendations on future arrangements for the oversight of audit quality in the public sector, but we do not anticipate any changes in arrangements in the near term that will impact upon our 2019/20 plan.

The FRC will continue to discharge and report on our supervisory responsibility as the Independent Supervisor of Auditors General in respect of statutory audits through arrangements agreed with the Comptroller & Auditor General.

Consistent with the Memorandum of Understanding signed in 2014 between FRC, the Institute of Chartered Accountants in England and Wales (ICAEW) and the regulatory authorities in the Isle of Man, Jersey and Guernsey, we will continue to oversee the ICAEW's procedures for monitoring audit work of approved audit firms and auditors in the Crown Dependencies, where the quality of audit work is measured against auditing standards applicable in the UK.

Oversight of the accountancy profession

By agreement with the chartered accountancy bodies, the FRC team exercises independent oversight of the regulation of the accountancy profession. The Government welcomes the proposals by the Independent Review to enhance the regulator's role in oversight of the accountancy profession.

In 2019/20, the FRC will develop a broader work programme in order to support its role in identifying emerging concerns of public interest arising from its oversight role and will establish individual memoranda of understanding with each of the UK's professional accountancy bodies.

Measuring our performance and impact

In assessing progress on this element of our work programme we will take account of a range of indicators:

- The findings from the FRC's annual audit quality reviews - including the proportion of FTSE 350 audits that require no more than limited improvements.
- RSB data on the quality of audits that are not within the scope of FRC monitoring.
- Evidence from our reviews of the quality of local public body audit.

Corporate reporting

The FRC is responsible for setting UK standards for accounting and for monitoring and taking action to promote the quality of corporate reporting. We work closely with international standard-setters and authorities in other jurisdictions.

In 2019/20 we will promote high quality corporate reporting through:

Our programme of corporate reporting reviews

Our corporate reporting activity aims to identify opportunities for improving the quality of corporate reporting to provide users with a sound basis on which to base their investment decisions. In our October 2018 report, we were disappointed to report that we had identified a higher number of basic errors or mistakes in reviewing 2016/17 accounts, pointing to the need for improvement in 2017/18 accounts. Recent years have seen a focus on the reporting of management judgements and estimates and alternative performance measures, which are central to understanding the quality of reported results and their sensitivity to changes in assumptions which can affect future years. Both topics have been the subject of thematic reports highlighting our expectations in these areas of reporting.

In its consultation on the Independent Review, the Government welcomes the proposals to strengthen the corporate reporting review function within the FRC. The Government supports the proposal to extend the corporate reporting review process to the entire annual report. The FRC will commence taking this forward. In parallel, the Government will take forward discussions with the Financial Conduct Authority (FCA) and the FRC to consider the case for strengthening qualitative regulation around a wider range of investor information than is covered by the FRC's existing corporate reporting review work. The Government will consult on any proposals which emerge from those discussions in due course.

The Independent Review includes recommendations designed to increase the impact and visibility of the FRC's corporate reporting review work, requiring legislative change. The Review also makes the suggestion that the volume of review work should be expanded. We aim to make a start on this objective in 2019/20 and have allocated additional resource within our draft budget.

The Government welcomes the recommendation to give ARGA a power to direct changes to accounts and will bring forward a legislative power as soon as Parliamentary time allows. The Government also supports the recommendation that, once established, the new regulator should set up a service to provide, for a fee, pre-clearance of the treatment of novel and contentious matters in accounts in advance of their publication. Such a procedure should be piloted initially.

Complementing the changes resulting from the Independent Review, in 2019/20 we will:

- As previously announced, follow up on our thematic reports, published in November last year, on the adoption of IFRS 9 and IFRS 15 in June 2018 interim reports. We will continue our analysis by reviewing the more extensive set of year-end disclosures required in respect of a sample of companies, selected from those industries where we expect the standards to have had the most impact.
- Monitor companies' disclosures relating to IFRS 16, 'Leases', in 2019 interim reports where we expect to see explanations of the impact of the new standard which is mandatory from 1 January this year.
- Conduct a thematic review of impairment of non-financial assets.

In a change to our previous practice, we have made only limited use of pre-informing companies of our intention of including their reports in our samples for thematic review. This is to allow us to remain as flexible as possible and respond to the poorer reporting we might see in practice rather than commit ourselves to looking at reports that have already been re-considered and improved by management prior to publication.

We will publish our annual review of corporate reporting in the UK.

The future of corporate reporting

We announced a major project on the Future of Corporate Reporting in 2018 to challenge existing understanding and thinking about corporate reporting and consider how companies should better meet the information needs of shareholders and other stakeholders. In recent years there has been a growing debate about the purpose of companies' annual reports and the audience for these reports. Reporting requirements have continued to increase and there is an ongoing desire of users for more streamlined annual reports. The FRC will seek a balance between the needs of users and the proportionate costs and practicalities for companies of providing information. We will review current financial and non-financial reporting practices, consider what information investors and other stakeholders require, and review the fundamental purpose of corporate reporting and the annual report. In that context we will also examine other types of corporate communications.

The Future of Corporate Reporting project will consider how wider sustainability matters can be reported effectively. The Financial Reporting Lab is carrying out a project specifically on climate reporting which seeks to identify practical ways in which companies provide information on climate change risk in their reporting. In our monitoring activities we will consider whether that information, and the assurance provided, are adequate.

The Financial Reporting Lab has also been considering how different technologies are (and potentially will) influence the way in which companies communicate with their stakeholders. The FRC's work on the Future of Corporate Reporting and the Brydon Review will consider the impact of technological developments.

In 2019/20, the Lab will:

- Continue to focus on improving aspects of the strategic report (including business models, risk and viability, performance metrics and dividend policy and practice) by reviewing current reporting practice in these areas.
- Start a project on how companies report on the sources and uses of cash to provide greater transparency on the financial health of a company, how it generates cash and what it does with that cash.
- Consider how improvements can be made in the reporting in relation to the environment and the workforce.
- Explore how the different ways people connect with data and corporate information will affect corporate reporting in the future, and the impact of emerging technologies.

We will follow-up the consultation launched in February 2019 on possible improvements to the reporting of factors that are important to a business' generation of value, including proposals for improving the reporting of information on intangibles.

The International Accounting Standards Board (IASB) issued IFRS 17 *Insurance Contracts* in May 2017. This is the first comprehensive IFRS on accounting for insurance contracts issued and reinsurance contracts held and will create significant changes in the accounts of insurance companies around the world. Since it was issued a number of concerns have been raised about its requirements. The IASB has responded by reviewing the standard in advance of its effective date and are expected to propose amendments in the coming months.

The FRC will continue to engage constructively with the IASB to bring about improvements to the standard and, with the European Financial Reporting Advisory Group (EFRAG) to support the European endorsement process. If the revised standard has not been endorsed in Europe by the date of the UK's exit from the EU, it will fall to the new UK Endorsement Board to determine whether it should be applied in the UK.

The FRC, alongside colleagues in the new UK Endorsement Board, will continue to engage with national standard-setters around the world in support of a single set of high-quality international accounting standards.

Measuring our performance and impact

In assessing progress on this element of our work programme we will consider:

- Evidence from our corporate reporting reviews, including the quality of reporting by large public companies and smaller listed and AIM quoted companies.
- Evidence of the impact on the quality of reporting through pre-informed thematic reviews.
- Our assessment of the impact of the Financial Reporting Lab's initiatives, including those relating to business model reporting and risk and viability reporting.
- Evidence on the quality of reporting from surveys by other regulators, bodies and market commentators.
- Evidence of changes in the landscape for corporate reporting, the impact of new technology, and companies' response to changing expectations for corporate reporting.

Corporate governance and investor stewardship

The new UK Corporate Governance Code introduced in 2018 has been well received and we will be assessing how effectively companies are implementing it. The new Code has substantially evolved. It is shorter and sharper than the previous Code, with a renewed emphasis on the Principles and fewer Provisions. It takes a broader view of governance and emphasises the importance of a healthy corporate culture and constructive relations with a wider range of stakeholders in delivering long-term sustainable success. The intention is that, by reporting on the application of the Principles in a manner that can be evaluated, companies should demonstrate how the governance of the company contributes to its long-term sustainable success and achieves wider objectives. High-quality reporting on the application of the Code will include signposting and cross-referencing to other relevant parts of the annual report. As an important part of our work in 2019/20 we will extend our monitoring of practice and reporting on corporate governance, for which we have made provision in our draft budget.

Following the 2018 report from the Hampton Alexander Review, we are encouraging boards to take a more strategic approach to diversity and inclusion, and to consider their approach to reporting on it. We expected to see more of our largest companies providing greater information about their approach to boardroom diversity and insights on the actions they are taking to increase diversity at all levels. To maintain a competitive edge and success over the long-term, UK companies need to consider how diversity and inclusion is relevant to the markets in which they operate, and to all their stakeholders and the communities they serve.

We are consulting on a revised UK Stewardship Code which aims to increase demand for more effective stewardship and investment decision-making which is better aligned to the needs of institutional investors' clients and beneficiaries. The proposed Code sets out more rigorous reporting requirements and focuses on the outcomes of stewardship activities. The proposed Code also expects investors to report how their purpose, values and culture enable them to meet their obligations to clients and beneficiaries. This aligns it with the UK Corporate Governance Code in its expectation that investors report on how their purpose, values and culture enable them to meet their obligations to clients and beneficiaries. Signatories are expected to take material environmental, social and governance factors into account when fulfilling their stewardship responsibilities; and to exercise stewardship across a wider range of assets classes, in the UK and globally. Reporting will be subject to increased oversight by the FRC to ensure that the new Code, once finalised, is effective in raising the quality of stewardship across the investor community.

We are responding to the increasing focus on climate change. Both the revised UK Corporate Governance Code and the consultation on the Stewardship Code encourage companies and investors to consider they take account of environmental, social and governance considerations in their decision making and reporting.

In 2019/20 we will:

- Introduce a revised UK Stewardship Code, following the public consultation in 2018/19, assess Policy Statements and receive Activities and Outcomes Reports.
- Review compliance against the 2016 UK Corporate Governance Code and monitor ‘early adoption’ of the 2018 UK Corporate Governance Code, particularly in the areas of stakeholder engagement, culture, chair tenure, nomination committee reporting and remuneration. We will publish our assessment of both in the annual report on the quality of UK corporate governance and reporting.
- Begin work on introducing company-specific monitoring of corporate governance statements in 2020/21.
- Work with other members of the coalition group to promote the Wates principles as a corporate governance framework for large private companies.
- Consult on revisions to the *Guidance on Risk Management and Internal Control and Related Financial and Business Reporting*, including on the future of the viability statement and enhancement to reporting.

Measuring our performance and impact

In assessing progress on this strategic priority, we will consider:

- Listed companies’ response to the changes to the UK Corporate Governance Code.
- The quality of nominations committee reporting on board diversity and succession planning.
- The take-up and impact of the governance principles for large privately-owned companies.
- Survey evidence of the extent and effectiveness of investors’ engagement with companies.
- Evidence from the responses to our Stewardship Code consultation on the effectiveness of the framework.

Enforcement

Although the Independent Review welcomed the FRC's evident recent change in approach, and by the strengthening of the enforcement team's resourcing and new leadership of the enforcement function, the Review recommends that both the FRC Board and the Government should continue to monitor enforcement performance closely.

In 2019/20 we will for the first time publish a report that will provide an overview of our enforcement activities and our priorities going forward. The first report will be for the year to 31 March 2019. It will be aimed at improving the transparency of our operations and improving understanding of the schemes and procedures under which our enforcement activities are carried out. During 2018/19 financial penalties have nearly doubled from £12 million (before settlement discount) in 2016/17 to £23.3 million in 2018/19. In 2018/19, five Severe Reprimands and five Reprimands were published.

One of our current cases has attracted particular Parliamentary and public attention: the FRC's investigations in relation to the collapse of Carillion. The FRC will continue to meet regularly with case teams from other agencies on this case to identify issues of common interest and to ensure that relevant documents and information are shared to the extent permissible. The matters being investigated by the FRC are highly complex and will continue well into 2019.

We now pursue matters relating to inadequate audit under the Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR), which give us greater powers to obtain information and documents from certain audited entities. Our Audit Enforcement Procedure also provides that a greater range of breaches of relevant requirements of varying degrees of seriousness are potentially capable of attracting sanctions. We therefore expect to open an increasing number of investigations and that, where sanctions are merited, they will span a broader range to reflect the spectrum of the severity of findings.

We will continue to expand and strengthen our team to ensure that we have a sound platform for strong and timely enforcement action in the year ahead.

In 2019/20, we will:

- Take firm, fair and timely enforcement action to protect the public, uphold standards and deter misconduct.

- Ensure our investigations are progressed thoroughly, efficiently and in accordance with due process whilst continuing the drive to conclude investigations more quickly.

- Pay close attention to sanction setting, financial and non-financial, as a means of driving good regulatory outcomes through proportionate sanctions, financial and non-financial.
- Continue to engage with stakeholders to explain better our powers and approach
- Publish an annual review of Enforcement activity, including highlighting any thematic concerns.
- Be transparent about the outcome of individual investigations including where there is a clear public interest and subject to any applicable legal constraints, we will publish a summary of our reasons for closing an investigation.
- Continue to harness AI to improve the efficiency of our investigations and consider the impact of emerging audit technology on our investigation and enforcement processes.

Looking further ahead, the Government consultation on the Independent Review welcomes the proposals to review and enhance the sanctions regime for audit and for directors. Changes to this regime will require primary legislation and will require careful consideration of how any new policies interact with the existing enforcement framework. The proposal to extend the reach of the regulator's enforcement internationally will also need careful consideration to ensure that it can be effective and proportionate in the UK.

Measuring our performance and impact

We will assess our performance against our published KPI of a maximum of two years between commencement of investigation and service of Proposed Formal Complaint or Initial Investigation Report and will consider other evidence of the impact of our enforcement activities.

Actuarial standards and oversight

The Joint Forum on Actuarial Regulation (JFAR) was established in 2013 by the FRC, the Institute and Faculty of Actuaries (IFoA), the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Pensions Regulator (tPR) to coordinate the identification of, and responses to, the public interest risks relating to actuaries and actuarial work.

In 2019/20, in addition to supporting and contributing the work of the JFAR, we will:

- Prepare for the post-implementation review of the revised framework of Technical Actuarial Standards (TASs) which is planned for 2020/21. The current TASs were issued in December 2016 with an effective date of 1 July 2017. In line with FRC's policy, standards issued by the FRC will be kept under regular review and re-considered at least once every five years. We will therefore aim to publish any revised standards no later than 1 July 2022.

- Publish our Actuarial Statement of Recommended Practice 1: Financial Analysis of Social Security Pensions (ASORP 1). We published a consultation paper with a draft ASORP in November 2018, including the changes which we have proposed in respect of the adoption of the model standard *International Standard of Actuarial Practice 2: Financial Analysis of Social Security Programmes (ISAP2)* and intend to publish ASORP 1 in 2019.

- Undertake the annual review of the Actuarial Standard Technical Memorandum 1: Statutory Money Purchase Illustrations (ASTM1) which supports the disclosure requirements for money purchase pensions.

- Continue to influence the development of model international actuarial standards, through attendance at key meetings of the International Actuarial Association and the Actuarial Association of Europe and our response to consultations.

- Oversee the IFoA's planned approach to monitoring the quality of actuarial work.

The Independent Review recommended that Government, working with the PRA and tPR, should review what powers are required effectively to oversee regulation of the actuarial profession. The work programme and budget for actuarial activities in this consultation paper are, therefore, subject to Government decisions on the future shape of actuarial regulation.

Measuring our performance and impact

We will assess progress primarily through feedback on the TASs and the JFAR Risk Perspective.

Three - Expenditure and funding

To implement our proposed 2019/20 Plan, we have set the following budget (Table 1). The overall budget of £38.1m, which includes both core operating costs and case costs, represents an increase of 5% compared to our 2018/19 budget of £36.3m and 11% compared to our expected 2018/19 outturn of £34.4m. The budget set out in Table 1 does not include additional costs relating to EU exit or the implementation of the Independent Review which we cannot accurately forecast at this stage. An indicative range for these additional costs is set out in Table 4.

1.1 Table 1: Budget	**2018/19 Budget**	**2018/19 Forecast**	**2019/20 Budget**
	£m	**£m**	**£m**
AUDIT AND ASSURANCE			
Audit Quality Review	8.9	8.7	9.8
Audit & Assurance Standards	2.3	2.2	2.1
Audit Firm Monitoring and Supervision	0.9	0.1	1.3
PROFESSIONAL OVERSIGHT			
Professional Oversight	2.2	2.3	2.9
Third Country Auditors – Registration	0.2	0.2	0.3
ENFORCEMENT			
Enforcement Core Costs	3.3	3.3	3.3
Enforcement Case Costs	5.0	5.0	5.0
CORPORATE GOVERNANCE & REPORTING			
Corporate Governance and Stewardship	1.1	1.3	1.4
Accounting and Reporting Standards	3.6	3.6	3.5
Corporate Reporting Review	4.9	4.6	4.9
Financial Reporting Lab	1.1	1.0	1.0
XBRL	0.2	0.3	0.2
ACTUARIAL			
Standards	1.8	1.5	1.8
Professional oversight	0.3	0.2	0.2
Actuarial Investigation costs	0.5	0.1	0.4
Total	**36.3**	**34.4**	**38.1**

The budget in Table 1 reflects our intention to:

Audit and assurance

- Expand our programme of audit quality reviews, supplemented by thematic reviews.
- Build up our team of inspectors to undertake more reviews of audits of local authorities and health bodies.
- Recruit staff with the necessary skills and experience to enable us to make a significant impact with our Audit Firm Monitoring and Supervisory Approach (AFMAS) in 2019/20.

Professional oversight

- Strengthen our oversight of the RSBs as part of our overall drive to improve audit quality.

Corporate reporting

- Increase the number of corporate reporting reviews we undertake.
- Take forward our major project on the Future of Corporate Reporting.

Corporate governance and investor stewardship

- Assess the extent of early adoption of the new UK Corporate Governance Code.
- Extend our monitoring of practice and reporting on corporate governance.
- Increased oversight of reporting on the stewardship to ensure that the new Stewardship Code, once finalised, is effective in raising the quality of stewardship across the investor community.

Enforcement

- We will continue to expand and strengthen our team to ensure that we have a sound platform for strong and timely enforcement action in the year ahead.

We have increased the proportion of our costs that are recovered from the professional bodies in relation to specific enforcement cases. Hence, although the team is expanding, core costs have not increased proportionately.

Expenditure type

The planned increase in our staff costs 2019/20 compared to 2018/19 shown in Table 2 below in part reflects a catch-up for the 2018/19 recruitment delays as well as the continued expansion of our regulatory activities.

Expenditure in 2018/19 on legal and associated costs reflects the work to prepare for EU exit.

Table 2: Budget - Expenditure type	**2018/19 Budget**	**2018/19 Forecast**	**2019/20 Budget**
	£m	**£m**	**£m**
Staff costs	22.0	20.8	24.5
NED and Committee Member Fees	1.5	1.5	1.4
Facility costs	2.0	2.1	2.2
IT & Website	0.8	0.9	1.0
Travel	0.5	0.4	0.4
Conferences	0.2	0.2	0.2
Recruitment	0.2	0.3	0.3
Training	0.3	0.2	0.2
Legal / professional / audit	1.3	1.2	0.6
Research	0.1	0.2	0.4
All others	1.7	1.2	1.3
XBRL	0.2	0.3	0.2
Total	**30.8**	**29.3**	**32.7**
Audit and Accountancy Case Costs	5.0	5.0	5.0
Actuarial Investigation Costs	0.5	0.1	0.4
Total	**36.3**	**34.4**	**38.1**

Funding

In establishing the contributions from our funding groups, we seek to recover the costs we expect to incur in each of our major areas of activity. Some elements of our expenditure, including audit and accountancy enforcement case costs, can be recovered from specific groups. Other elements are relevant to a number of different groups.

We propose to allocate our funding requirement for the budget we propose for 2019/20 (excluding additional costs relating to EU exit and the Independent Review) as follows:

Table 3: Funding sources	18/19 Budget £m	18/19 Forecast £m	19/20 Budget £m
Audit and accountancy			
RSB contribution to AQR funding	7.0	6.8	8.5
NAO & Crown Dependencies contribution to AQR funding*	0.9	1.2	0.6
CCAB contribution	4.1	4.1	4.2
CIMA contribution	0.7	0.7	0.7
Contribution to enforcement case costs	5.0	5.0	5.0
Contribution to AFMAS	0.6	0.1	1.2
Accounts preparers	14.8	14.0	14.6
Actuarial funding groups			
Insurance companies	1.2	1.1	1.1
Pension schemes	1.2	1.3	1.1
IFoA	0.2	0.2	0.2
Publications, XBRL and TCA registration fees	0.6	0.8	0.9
Total	**36.3**	**35.3**	**38.1**

* Our Audit Quality Review team carries out work under contract and receives payment from the PSAA, the National Audit Office and fees levied on Recognised Auditors registered in the Crown Dependencies. This work is, in part, cyclical: hence the reduction on costs in 2019/20.

Estimated additional expenditure – EU Exit and the Kingman Review

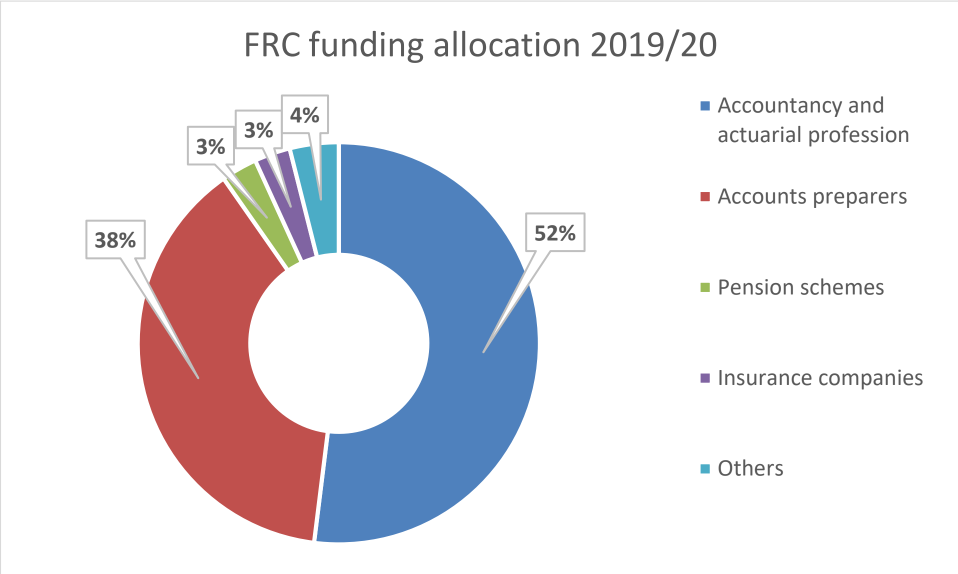
The additional costs that might arise in 2019/20 in relation to EU exit and in the transition towards the implementation of the recommendations of the Independent Review are at present unclear and are not included in the Plan set out in Section Two, or the budget in Table 1. They should become clearer as the form of EU exit is finalised and as BEIS consults on the Government response to the Independent Review.

The funding of additional costs will be agreed with BEIS. Any additional amounts that fall to be funded by our principal funding groups will be included in our finalised budget and, potentially, if uncertainty remains beyond our current funding cycle, in supplementary levies.

Table 4: Potential additional expenditure	19/20 Budget (Range)
	£m
IFRS Endorsement Board	1.0 - 1.8
EU Exit-related costs	0.4 - 1.5
Independent Review-related costs	1.0 - 1.6
TOTAL	**2.4 - 4.9**

Four – Proposed funding arrangements

The following chart summarises the contributions to our core costs we are requesting for 2019/20.



Our funding groups are as follows:

Audit and accountancy professional bodies

The accountancy profession's contribution is paid by the Consultative Committee of Accountancy Bodies (CCAB), whose members are ACCA, CAI, CIPFA, ICAEW, and ICAS; and by CIMA which contributes to the FRC's funding requirement under the terms of a separate agreement with the FRC.

The ICAEW, ICAS, ACCA and CAI are Recognised Supervisory Bodies (RSB) for audit under Schedule 10 of the Companies Act 2006. The FRC, as the audit competent authority, delegates certain audit regulatory tasks to each RSB under a Delegation Agreement. Schedule 10 of the Companies Act 2006 and each Delegation Agreement also place an obligation on an RSB to fund the FRC's performance of any tasks that have not been delegated where these relate to the regulation of auditors registered with that RSB. This covers the costs of the FRC's audit review activities, audit enforcement activities and standard-setting procedures and from 2018/19 our audit firm monitoring and supervisory approach.

As we explained in our 2019/21 Strategy, if the FRC's audit enforcement work results in a statutory fine, that fine is required to be paid to the Secretary of State by the Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR). Any costs that are recovered are returned to the funding bodies.

Case costs under the accountancy scheme (which would previously have covered cases that are now be subject to the SATCAR arrangements) are met by the individual participating body 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. Any fine income received by, or legal costs awarded to, the FRC in relation to disciplinary cases subject to the accountancy scheme are returned to the participating bodies which met the related case costs.

Our Audit Quality Review team carries out work under contract and receives payment from the PSAA, the National Audit Office and fees levied on Recognised Auditors registered in the Crown Dependencies. In 2019 funding for our new responsibilities to monitor local public audit will be provided by the relevant accountancy bodies.

Preparers levy

The preparers levy is the annual levy we request from:

- companies listed on the London Stock Exchange with a Premium or Standard listing.
- UK companies quoted on AIM and listed on ISDX (previously known as PLUS) Market group.
- large private entities with a turnover of £500m or more.
- Global Depository Receipt (GDR) issuers.
- Government Departments, local authorities and other public sector organisations.

The total amount of the preparers levy for 2019/20, subject to any additional requirements associated with the establishment of the IFRS Endorsement Board and the Government consultation on the Independent Review, will be £14.6m. In addition to this the FRC will aim to collect the UK contribution to the funding of the IASB, totalling £0.9m in 2018/19.

The amounts payable are determined through a minimum levy and further amounts for organisations above a certain size, with the rate per £m of market capitalisation declining in five levy bands, aligned with the FCA levy arrangements. The amounts finally requested from individual levy payers are based on their market capitalisation as at the end of November 2018 (for listed companies), and on the latest available data on turnover for other companies, and annual gross expenditure for public sector organisations.

We are proposing the following levy rates:

	Organisation size per £m*	**2019/20 Preparers levy rate**
Minimum fee for all companies		£1,116
Additional fees based on the following levy bands		
1	100m - 250m	£10.95
2	250m - 1,000m	£8.35
3	1,000m - 5,000m	£8.08
4	5,000m - 25,000m	£0.1315
5	> 25,000m	£0.0249

Discounts: Companies with a Standard listing receive a 20% discount. UK AIM quoted and ISDX listed companies receive a 50% discount. Private entities with a turnover of more than £500m receive a 50% discount. Public sector organisations receive a 75% discount. The following table gives examples of the levy that will be charged to different types of entity:

Organisation	**2019/20 levy**
UK AIM company with £100m market cap	£558
Private company with £750m turnover	£3,465
Premium listed company: £10bn market cap	£41,989

We are maintaining the levy on Global Depository Receipt issuers at the same level as in 2018/19: £3,450 for companies that have designated the UK as their home competent authority and £2,750 for other issuers. The FCA's Home Competent Authority list is available at http://www.fsa.gov.uk/ukla/hcaList.do.

Levy requests

The FRC requests preparers, pension and insurance levy payments on the basis that the levies are non-statutory and collected on a voluntary basis. Should the system of voluntary payments prove unsustainable we would request that the Secretary of State make regulations to put the FRC's levies on a statutory basis. The Companies (Audit, Investigations and Community Enterprise) Act 2004 includes provisions to enable this.

Pension levy for 2019/20

The FRC pension levy applies to all Defined Benefit and Defined Contribution schemes with 5,000 members or more. We are proposing to raise £1.1m from the pension levy in 2019/20 and we will confirm the levy rate to be applied after receiving the data on scheme membership provided by the Pensions Regulator.

Insurance levy for 2019/20

The insurance levy is allocated to insurance companies as a proportion of the FCA and PRA regulatory fees and requested on the same invoice as the FCA/PRA fees. We are proposing to raise £1.1m from the insurance levy in 2019/20 and we will confirm the levy rate to be applied on the basis of the FCA/PRA fees once these are confirmed.

Institute and Faculty of Actuaries (IFoA)

When the FRC assumed its responsibilities for actuarial standards and regulation in April 2006, it was agreed that the IFoA would contribute a share equivalent to 10% of the cost of our actuarial activities. We have maintained this approach for 2019/20.

Third Country Auditors – Registration and renewal fees

A third country auditor seeking registration in the UK must pay to the FRC a fee upon application and an annual fee thereafter for renewal of its registration in accordance with the Third Country Auditors (Fees) Instrument 2011.

This fee is based upon our anticipated costs to administer the regime. The amounts payable are determined by the anticipated cost of processing applications from each of the three categories of registration; Equivalent, Transitional or Article 45 of the Statutory Audit Directive. Audit firms from countries which have not been assessed as having audit oversight, monitoring and discipline regimes equivalent to those of the European member states or regimes which are moving in that direction involve the greatest amount of processing and therefore incur the highest fees.

The fee structure for 2019/20 is set out below.

	0-9 relevant clients		10+ relevant clients	
	Equiv/trans	**Art 45**	**Equiv/trans**	**Art 45**
2019/20	**£1,136**	**£2,272**	**£2,840**	**£5,680**

Other income

The FRC also generates income from its publications, including from electronic rights. The XBRL project is funded by HMRC, the Charity Commission and UK Companies House.

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