



FINANCIAL REPORTING COUNCIL

PLAN & BUDGET 2005/06

DECEMBER 2004



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One - Introduction

The FRC's aim is to promote confidence in corporate reporting and governance.

Our Regulatory Strategy (which can be found on our website at www.frc.org.uk) provides the context for this Plan & Budget. In the Strategy we explain that our work in pursuing our aim is organised around five objectives, which are to promote:

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

The Strategy explains the principles which inform our approach to our work (our "regulatory philosophy") and sets out the work streams that have been established to help achieve our objectives. The Strategy also summarises the arrangements for our governance, funding and accountability.

From 1 April 2004 we started to undertake the wider and deeper functions which were given to us following the Government's review of the regulatory regime for corporate reporting, auditing and governance. Our new responsibilities are being phased in over three years.

This Plan & Budget sets out the major activities and projects we propose to undertake in the 12 months starting in April 2005 in pursuit of our objectives, the costs we expect to incur, and the basis on which these costs will be funded. Our priorities reflect our statutory responsibilities and our view of the greatest risks to confidence in corporate reporting and governance.

We welcome feedback from interested parties on any aspects of our proposals. It would be helpful if comments could reach us by 28 February 2005. Contact details are provided in Annex C.

If, as a result of comments received, we make any important changes to our proposed activities and projects we will publish a revised Plan.

We expect to decide the levy on listed companies by the end of May 2005.

Our organisational structure is shown in Annex A. A list of the abbreviations used in this document is provided in Annex B.

Two - Key features of the Plan & Budget

We are very conscious that 2005 is a year of major change for many companies, their shareholders and auditors. The introduction of international accounting standards, the OFR and revised auditing standards will all have important implications for those involved in corporate reporting and governance. In addition, there are a number of policy reviews that have been announced in 2004 which will continue during 2005.

In these circumstances we are not proposing any major new policy initiatives for 2005/06 but are focusing on finalising those which are already underway. We plan to make further progress in implementing the additional responsibilities we were given by the Government following their reviews of the implications for the UK of the major corporate scandals in the US in 2001 and 2002.

However, there continues to be a large number of policy proposals affecting corporate reporting and governance in the UK which are initiated by the EU and other international organisations. It is important that we use our influence to ensure that to the maximum degree possible these initiatives contribute to wealth and general prosperity, are proportionate to the issues they address and do not impose unnecessary burdens. An important feature of our work in 2005/06 will be taking an active role in helping to shape these initiatives, working with fellow regulators in the UK and internationally, and consulting and seeking support from those in the UK who are likely to be affected.

Our major activities and projects for 2005/06 are:

- increasing the pro-active enforcement of accounting standards
- broadening the coverage of our independent inspection of audits
- updating the Turnbull guidance on Internal Control
- issuing a reporting standard for the OFR
- reviewing implementation of the revised Combined Code on Corporate Governance
- developing a programme for convergence of UK accounting standards with IFRS
- taking on new statutory responsibilities for the regulation of auditing
- contributing to the improvement of international standards on auditing
- updating standards for reporting accountants in relation to investment circulars
- ensuring the effectiveness of the new independent investigation and discipline scheme

Our Strategy commits us to being a market-led and proportionate regulator. We have sought to live up to that commitment by proposing a budget for core operating costs in 2005/06 which is flat in cash terms compared to our original budget for 2004/05, which we published in November 2003. At the start of 2004/05 we re-assessed our expenditure plans and concluded that as a result of a phased implementation of our new responsibilities we could operate to a lower financial target (our "Operating Plan") of £9.3m.

We will continue the transfer of responsibility for inspection of audits of major public interest entities from the professional accountancy bodies to our Audit Inspection Unit.

We are proposing to introduce a fairer basis for calculating the levy on listed companies and are reviewing, in consultation with interested parties, whether other publicly traded companies should contribute to the costs of our work.

Three - major activities and projects

In this section we describe the major activities and projects which we propose to undertake in 2005/06. The sequence of material follows the objectives and work streams set out in our Regulatory Strategy (shown in bold).

Objective 1 - Promote high quality corporate reporting

a) Contributing to the development and implementation of IFRS

- Work with the IASB, other national standard-setters and EU institutions to develop high quality IFRS, including:
 - o joint projects to develop accounting standards and the principles to guide future standards
 - o leading the IASB's leasing project and participating in IASB groups on reporting comprehensive income and management commentary
 - o monitoring all IASB (including IFRIC) projects, including important new projects on insurance phase 2 and the longer-term thinking on financial instruments.

b) Influencing EU policy on accounting standards, including the endorsement of IFRS

- Contribute to EFRAG and continue to push for the speedy adoption of IFRS by the EU.
- Respond to IASB and EFRAG consultations on IFRS proposals.

c) Making progress on the convergence of UK accounting standards with IFRS

- Publish detailed plans for convergence in the light of the responses to our Discussion Paper 'UK Accounting Standards: A Strategy for Convergence with IFRS' and the IASB's proposed timetable.

d) Improving other aspects of UK accounting standards

- Continue work on:
 - o insurance accounting
 - o a 'one-stop shop' FRSSE
 - o an interpretation of the 'Statement of Principles for Financial Reporting' for Public Benefit Entities
 - o maintaining and reviewing SORPs.
- Addressing urgent issues requiring interpretations which arise during the year.

e) Improving communications between companies and investors, including developing and implementing standards for the OFR

- Issue a reporting standard and implementation guidelines for the OFR.

f) Pro-actively enforcing accounting and other corporate reporting standards

- One of the major decisions resulting from the Government's review of the regulatory regime for accountancy and auditing was that the enforcement of accounting standards should be put on a pro-active basis rather than the previous complaints-driven basis. This decision has led to a significant increase in the resources devoted to enforcement. In 2004/05 we started to implement a pro-active approach and we shall continue to increase our resources in 2005/06.
- We will extend our enforcement programme by:
 - o reviewing the annual accounts of a wider range of entities
 - o reviewing, for the first time, interim accounts
 - o introducing new selection criteria.
- The range of organisations whose accounts may be reviewed will be increased to include UK non-corporate entities and non-UK entities which have certain securities listed in the UK.
- We will review interim accounts, starting with those prepared for periods beginning on or after 1 January 2005.
- Advised by the Standing Advisory Group on Pro-activity, we will apply selection criteria based on industry sectors, specific accounting requirements and company-specific trigger factors:
 - o In 2005/06 we will focus on the following industry sectors: automobile, pharmaceutical, retail, transport and utilities.
 - o In terms of specific accounting requirements we will focus on entities whose annual accounts are expected to undergo significant change as a result of IFRS.
 - o We will continue to place particular emphasis on FTSE 350, but will also include smaller listed companies, other publicly traded companies, public limited companies and large private companies.
- We will continue to respond to matters drawn to our attention as a result of complaints or public comment, encouraging referrals from the City and elsewhere.

g) Influencing EU policy and practice on the enforcement of accounting standards

- Contribute to the development of a consistent and appropriate approach to the enforcement of accounting requirements across the EU through our role as technical adviser to the FSA on the CESR-Fin Sub-Committee on Enforcement, and as an active member of the European Enforcers Coordination Sessions in which all EU national enforcement authorities participate.

Objective 2 - Promote high quality auditing

a) Contributing to the development and implementation of ISAs

- Work with the IAASB, with other national standard setters and EU institutions to develop high quality ISAs. IAASB projects of particular importance will be those to improve existing standards on group audits, materiality, accounting estimates and related parties.

b) Making progress on the convergence of UK auditing standards with ISAs

- Revise UK and Irish audit opinions in the light of revisions to the international standard on audit reports and update existing Practice Notes and Bulletins.

c) Improving other aspects of UK auditing standards and guidance

- Issue a Bulletin to provide illustrative audit opinions (including references to IFRS).
- Update other Bulletins to reflect changes in regulatory requirements and changes to the Listing Rules.
- Issue guidance in relation to auditors' responsibilities relating to the OFR.
- Finalise the Bulletin 'Directors' compliance statements: Reports by auditors under company law in the Republic of Ireland'.

d) Improving ethical standards for auditors in the UK

- Monitor the implementation and impact of APB Ethical Standards for Auditors and provide additional guidance if needed.
- Contribute to the work of IFAC in the revision of its Code of Ethics.

e) Undertaking specific statutory duties of regulation in relation to auditing and the supervision of the auditing profession by the recognised supervisory and qualifying bodies

- Update documentation of the regulatory processes of RSBs and RQB's and monitor compliance.
- Establish RSBs' compliance with the new requirements of the C(AICE) Act 2004.
- Evaluate existing regulations on information available to the public about auditors under Part 2 of Schedules 11 and 12 of the Companies Act 1989 and the potential need to replace this with regulations made under POBA's delegated powers to comply with new disclosure requirements in the revised 8th Company Law Directive.

- Evaluate applications to become RSBs and RQB's and applications for approval of overseas audit qualifications under Section 33 of the Companies Act 1989.
- Consider (with DTI) the development of audit quality and sanctions for poor quality audits.

f) Monitoring the quality of the auditing function in relation to listed companies and any other entity in whose financial condition there is a major public interest

- Another major decision resulting from the Government's review of the regulatory regime for the accountancy profession was the creation of a new audit inspection unit to take over from the professional bodies the responsibility for monitoring the audit of those entities whose activities have the greatest potential to adversely affect financial and economic stability. The new unit will examine the quality of auditing across a wide range of companies and other entities, with a corresponding increase in resources. In 2004/05 we started our monitoring work by looking at the Big 4 audit firms and their audits of FTSE 350 companies.
- In 2005/06 we will extend our coverage beyond the Big 4 to the next tier of firms (the "Mid 5") who audit a significant number of listed or major public interest entities. The intention is that all the Mid 5 will be subject to a full review in 2005/06.
- Review all audits of the FTSE 350 audited by firms outside the Big 4 and Mid 5. There are currently 4 such audits, 2 of which are investment trusts.
- Work with the professional accountancy bodies to ensure that the regulatory framework to enable our inspections to be carried out is satisfactory and develop a framework for reporting to the ARCs and ensuring they take appropriate action on our reports.
- Work with the professional accountancy bodies to develop an annual return process to capture all the audits of interest to the AIU.

g) Contributing to UK Government input on proposed EU legislation and policies on audit; and working with Government to implement them.

- Contribute to the finalisation of the 8th Directive and commence preparations for its implementation in the UK.
- Encourage the adoption of ISAs in the EU.

h) Promoting increased cooperation among international independent audit regulatory authorities

- Develop an approach to the review of international audits, develop working practices with PCAOB and other overseas regulators, and share inspection best practice internationally.
- Promote coordination of the regulation of audit and the oversight of the auditing profession in the EU.

- Promote arrangements for international cooperation and coordination between independent audit regulatory authorities.
- Develop and implement (with DTI) a strategy for anticipating and responding to overseas audit regulation with a UK impact.

Objective 3 - Promote high standards of corporate governance

a) Maintaining an effective Combined Code on Corporate Governance and promoting its widespread application

- Review implementation of the revised Combined Code and, if necessary, consult on any proposed revisions to the Code.
- Promote the Combined Code by encouraging its effective application and disseminating best practice.

b) Ensuring that the guidance on internal control and audit committees is current and relevant

- Complete the review of Turnbull guidance on internal control and issue any revised guidance to take effect from 1 January 2006.

c) Influencing EU and global corporate governance developments

- Influence the development and implementation of the European Commission's Corporate Governance Action Plan, directly and through the EU Corporate Governance Forum, and assist the DTI on corporate governance initiatives planned for the UK Presidency.

d) Helping to promote boardroom professionalism and diversity

- Encourage effective application of the relevant principles and provisions of the Combined Code.
- Work with the DTI and others to encourage the market for the supply of training for directors and for board evaluation services.

e) Encouraging constructive interaction between company boards and institutional shareholders

- Keep under review initiatives to facilitate dialogue between boards and investors and contribute to those activities where it is helpful to do so.

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

a) Overseeing the way in which the professional bodies exercise their regulatory responsibilities in relation to their members

- Undertake initial research to identify issues that could adversely affect public confidence in the profession and which could be addressed through recommendations to the professional bodies or the development of new standards. Undertake at least three reviews in the year to March 2006 together with ongoing work on mitigating possible risks.
- Follow up recommendations from 2004/05 projects on complaints and discipline and training and education.
- Publish an annual report on 'Key Trends' within the accounting profession

b) Operating an independent investigation and discipline scheme for matters which raise or appear to raise important issues affecting the public interest

- Investigate public interest matters referred to or called in by AIDB and hold disciplinary hearings and any consequent appeal hearings in relation to matters in respect of which a complaint has been made by the Executive Counsel.
- Review the operation of the AIDB Scheme to ensure that it is operating fairly, efficiently and effectively.
- Enlarge the Scheme to include ICAS and ICAI, and carry out a review of the case costs funding model proposed by ICAS.

c) Establishing standards and related guidance for accountants providing assurance services

- Ensure that standards and guidance reflect the significant changes to the existing regime under which reporting accountants perform their work on investment circulars. Update SIR 100 and 200 and issue new SIRs on 'Profit forecasts' and 'Pro-forma information' to comply with the requirements of EU Prospectus Directive.
- Issue APB Ethical Standards for Reporting Accountants to support the new and revised SIRs.
- Undertake research, in the light of recent changes in audit thresholds and strengthened standards, into the attitudes of preparers and issuers of financial statements of small and medium sized enterprises to identify and confirm relevant issues, establish their needs and consider proposed solutions, including the need for alternative forms of assurance.

Objective 5 - Promote our effectiveness as an independent regulator

a) Ensuring that we have adequate resources and management processes

- Maintain membership of the Council and all operating bodies as close as possible to their target levels with appropriately qualified people.
- Develop our use of IT to increase our effectiveness and efficiency, including:
 - o implementing systems for risk assessment, project management and remote working
 - o developing our website and intranet.
- Ensure high quality training for members of our operating bodies and for our staff that meets our operational needs as a unified independent regulator.
- Co-operate with Government to make best use of available resources in our activities and projects.

b) Meeting the principles of good regulation and ensuring that we are transparent, accountable and demonstrate our effectiveness

- Report on our performance by publishing our Annual Report for 2004/05, which will include a report on the way we have sought to meet the BRTF Principles of Good Regulation and embed the "regulatory philosophy" set out in our Strategy in our work, including:
 - o the way in which we measure and assess our performance
 - o open and timely consultation on, and preparation of, Regulatory Impact Assessments for new proposals
 - o appropriate publicity about our work on monitoring, enforcement and discipline.
- Make available on our website up to date information on the work of the Council and the operating bodies, including summary minutes of meetings, subject to issues of necessary confidentiality.
- Open ourselves to scrutiny by holding an Open Annual Meeting.
- Publish and invite comments on our Plan & Budget for 2006/07.

c) Developing cooperative arrangements with other regulatory organisations whose activities are relevant to our objectives

- Keep in close touch with the DTI, HMT and the FSA to ensure that our activities are co-ordinated where appropriate.
- Maintain, and where necessary develop, good working relationships with EU and international organisations and with organisations in other jurisdictions with similar responsibilities and interests.
- Ensure continued effective input into international negotiations on issues that fall within our remit.
- Work with the DTI to influence positively the development of corporate reporting and auditing in Europe and internationally.

d) Ensuring that we are recognised in the UK and internationally as a credible, authoritative and influential organisation

- Manage our key relationships, including those with:
 - o the CCAB and other key stakeholders
 - o the EU Commission and international regulatory and professional organisations
 - o the press and other media contacts.
- Review the relevance of our objectives and functions to public benefit entities and agree priorities for future activities and programmes.

Four - Expenditure and funding

Our Financial Management and Reporting Framework, set out in our Strategy, provides the framework within which we manage and report on the costs of our activities and how they are funded.

The framework identifies four categories of activity:

- **core operating costs** which are both subject to firm budgetary limits and are funded by the tri-partite arrangement, under which they are met in equal proportions by the business community, the accountancy profession and the government. Core operating costs include employment costs, accommodation, IT, professional services and other costs.
- **Audit Inspection costs** which include only the specific and variable costs of the AIU. The fixed overheads of the AIU (principally office accommodation and shared IT systems) are included in core operating costs. The Audit Inspection costs are met by the individual participating bodies with which the firms that are subject to inspection are registered.
- **Investigation & Disciplinary Case costs**, which include only the specific and variable costs of cases taken by the AIDB. The other costs of the AIDB (principally staff, accommodation, shared IT systems and other overheads) are included in core operating costs. The case costs are met by the individual participating bodies to which the members or firms that are the subject of each case belong. The total of these costs will depend on the number and complexity of cases and cannot be subject to firm budgetary limits. In the event of disciplinary complaints being brought, the disciplinary tribunals have powers to award costs against those found guilty of misconduct.
- **Review Panel Case costs**, which include only the specific and variable costs of cases which the FRRP decides to take to court or prepares to take to the Courts. The other costs of the FRRP (principally the Director and other staff, office accommodation and shared IT systems) are included in core operating costs. These costs are met in the first instance from the Review Panel Case costs fund (currently £2m), which is then replenished in the following financial year under the tri-partite funding arrangement.

Summary of expenditure

	Budget	Operating Plan
	2005/06	2004/05
	£m	£m
Core operating costs	10.3	9.3
Audit inspection costs	2.2	1.1
Investigation & Disciplinary costs	-	-
Review Panel Case costs	-	-
	<hr/>	<hr/>
Total	12.5	10.4
	<hr/> <hr/>	<hr/> <hr/>

Core operating costs

The proposed budget for core operating costs for 2005/06 is £10.3m, which is unchanged from the original budget for 2004/05 but is higher than our revised Operating Plan of £9.3m.

Analysis by category of expenditure:

	Budget	Operating Plan
	2005/06	2004/05
	£m	£m
Staff costs	6.6	5.5
Accommodation costs	1.1	1.1
Professional fees	0.7	0.5
IT costs	0.5	0.1
Other costs	1.1	0.9
Contingency	0.3	0.1
	<hr/>	<hr/>
	10.3	8.2
Sundry income	(0.2)	(0.2)
Capital expenditure	0.2	1.3
	<hr/>	<hr/>
	10.3	9.3
	<hr/> <hr/>	<hr/> <hr/>
Staff numbers	59	51

The budget for staff costs reflects the increase in staff necessary to deal with our new responsibilities. The number of staff, which has increased significantly as a result of the additional responsibilities which we have been given, is not expected to increase significantly in future years unless our responsibilities are further increased.

The budget for accommodation costs reflects the financing for rent, rates and service charges for our new office, which now provides a single base for our operations, and the residual cost of one of our former premises. The increase in budget for professional fees reflects our expanded role, which has increased our need for legal and professional advice. The budget for IT includes initial development of the additional capabilities described under Objective 5(a).

The contingency provides a modest allowance for activities and projects which had not been identified by the time this Plan was finalised.

The reduction in capital expenditure reflects the completion of the fit-out of our new office during 2004/05.

Analysis by operating unit

	Budget 2005/06		Operating Plan 2004/05	
	£m	Staff	£m	Staff
ASB	2.7	15	2.9	16
APB	1.3	7	1.3	7
FRRP	1.9	11	1.3	8
POBA	1.2	7	1.2	6
AIDB	0.9	4	0.8	4
CGU	0.1	1	0.1	1
Support Services	1.0	8	0.7	4
Corporate	1.2	6	1.0	5
	10.3	59	9.3	51

These figures represent the core operating costs of each operating unit plus an allocation of the central overheads based on the number of full time staff in each operating unit.

The major increase is in the FRRP where there will be a significant increase in the scope of its responsibilities as described under Objective 1(f).

The increase in Support Services numbers reflects the need to ensure the effective operation of our new office to support the higher standards of transparency and accountability which we are now expected to meet.

Audit Inspection Unit

The only other category of costs which is susceptible to normal budgetary limits is the AIU. The budget for the AIU is £2.2 million, which is the cost of meeting the programme of independent audit inspections discussed under Objective 2 (f). The significant increase in costs over 2004/05 is because the AIU's responsibilities are being implemented progressively over three years. Some of the AIU's activities in 2005/06 would have been undertaken in previous years by the professional accountancy bodies. The AIU expects to have 18 staff in 2005/06 compared to 10 in 2004/05.

The levy on listed companies for 2005/06

The levy on listed companies is collected on behalf of the FRC by the Financial Services Authority at the same time that it collects its own fees, which helps to reduce the costs of collection.

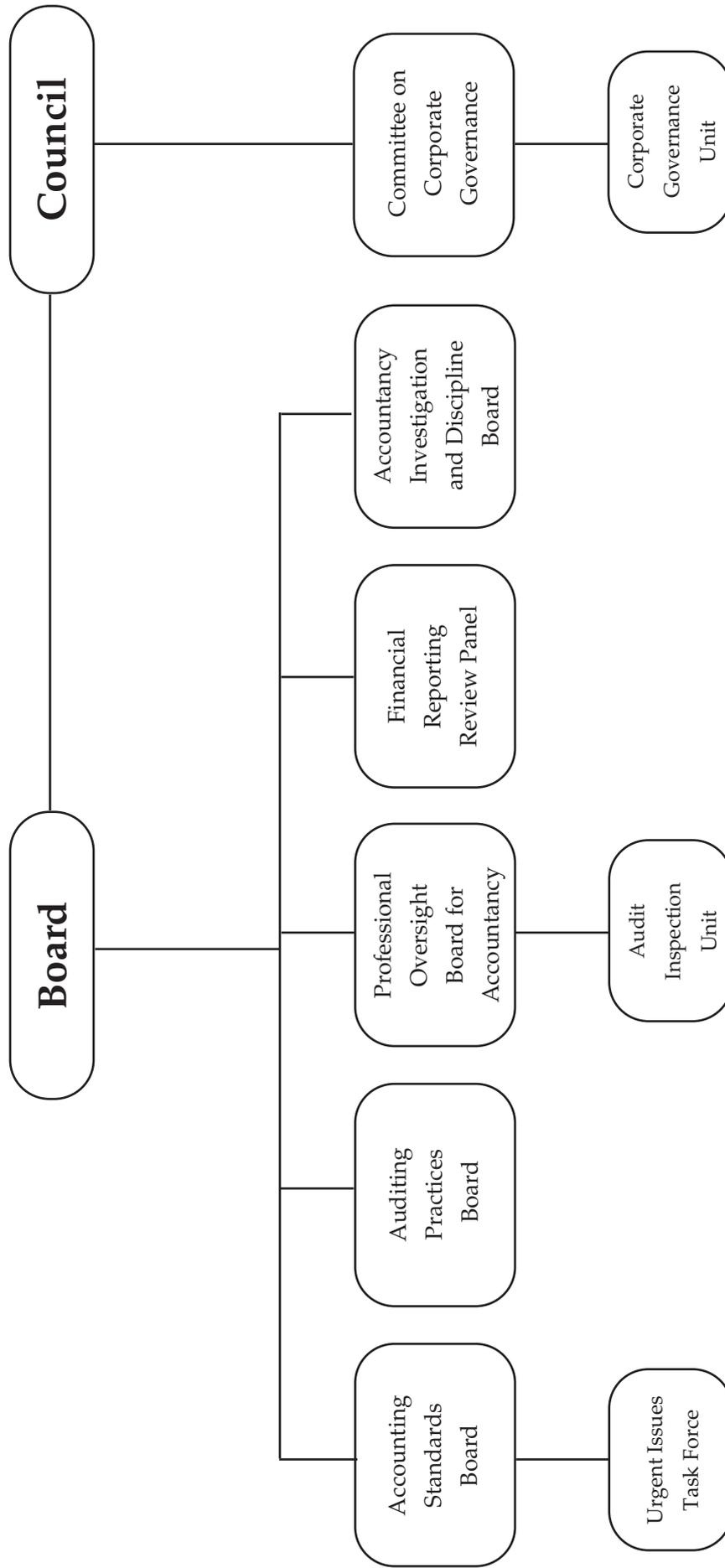
For 2004/05, we set a higher levy rate for companies in the FTSE 350 because they have a greater potential impact on our aim of promoting confidence in corporate reporting and governance. On 18 June 2004, we announced that we intended to change the basis of our levy with effect from 1 April 2005 from flat fees to a fee related to market capitalisation, which we believe is fairer. The FSA has announced a similar change in its own fee basis. We also announced that we would review the possibility of expanding the range of public companies that contribute to our costs.

In order to minimise the costs of setting our market-capitalisation levy we will base them on those of the FSA. The FSA will be announcing its fee proposals towards the end of January 2005 and we will announce our proposed levy rates at the same time. A feature of the market-capitalisation based levy is that there will be a minimum levy for smaller companies which we expect will be lower than the £1,600 payable in 2004/05 by companies outside the FTSE 350.

Our Budget proposals result in an increase in the levy for listed companies of around 10% on average, although there will be considerable variation around this average for companies of different sizes.

Most of our activities (with the exception of our work on corporate governance, which is only around 1% of our costs) apply to other publicly traded companies (principally those traded on AIM) as well as listed companies; however, only listed companies contribute to our costs. We believe that there is a case for extending our levy to include AIM companies and, possibly also to other publicly traded companies. We will provide an update on this issue in January 2005 when we publish our proposed levy rates.

Annex A - Organisational structure



Annex B - Abbreviations

AIDB	Accountancy Investigation and Discipline Board
AIM	Alternative Investment Market
AIU	Audit Inspection Unit
APB	Auditing Practices Board
ARC	Audit Registration Committee
ASB	Accounting Standards Board
BRTF	Better Regulation Task Force
C(AICE)	Companies (Audit, Investigations & Community Enterprise) Act
CESR	Committee of European Securities Regulators
CGU	Corporate Governance Unit
DTI	Department of Trade and Industry
EFRAG	European Financial Reporting Advisory Group
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FRSSE	Financial Reporting Standard for Smaller Entities
FSA	Financial Services Authority
HMT	Her Majesty's Treasury
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICAI	Institute of Chartered Accountants in Ireland
ICAS	Institute of Chartered Accountants of Scotland
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
IFRIC	International Financial Reporting Interpretations Committee
ISA	International Standard on Auditing
OFR	Operating and Financial Review
PCAOB	Public Company Accounting Oversight Board
POBA	Professional Oversight Board for Accountancy
RQB	Recognised Qualifying Body
RSB	Recognised Supervisory Body
SIR	Statement of Investment Circular Reporting Standard
SORP	Statement of Recommended Practice
UITF	Urgent Issues Task Force

Annex C - contact details

Comments on the Regulatory Strategy should be sent to:

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