



FRC Draft Plan & Budget and Levy Proposals 2016/17

ICAEW welcomes the opportunity to comment on the FRC Draft Plan & Budget and Levy Proposals 2016/17 published in December 2015 a copy of which is available from this [link](#). This response was submitted on 11 February 2016 by ICAEW.

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MAJOR POINTS

1. The FRC has added value through its activities in a number of areas, principally the Financial Reporting Lab, efforts by the Corporate Reporting Review Panel to follow the 'clear and concise' initiative and the work to improve the quality of reporting by smaller listed and UK AIM companies. ICAEW also supports the FRC's views on transferring some of the audit practice notes and bulletins into the SORP regime, sharing the maintenance role with professional bodies and reducing the call on FRC resources.
2. The Proposed Plan & Budget (PPB) would be improved by further explanation of the FRC's intentions, for example the proposal to broaden the scope of its annual assessment of the quality of UK corporate reporting and how the results of reports and audits reviewed under the 'advance warning system' will be communicated.
3. The case for redefining certain FRC audit related activities as 'audit regulation' is not clearly explained or justified in the PPB. The FRC proposes to transfer £4.5m of current spend to 'audit regulation', to be borne exclusively by the accountancy profession. Other than AQRT and professional discipline activities which are already wholly funded by the profession, we question why the costs of other activities carried out to promote the FRC's stated objective of promoting 'high quality auditing in the *public interest*' are not shared across a wider range of stakeholders who also benefit from them.
4. The 2016/17 budget is presented as being in line with 2015/16 budget, but there is actually an increase of £2.4m (7.7%) from the current financial year forecast. The PPB does not provide sufficient detail to assess the reasons for and value to be gained from proposed increases in certain areas of activity. The proposed increase in staff costs of £1.5m should be explained in terms of current staff levels, how many more staff will be added and what they will be deployed on.
5. We recognise that implementing the Audit Regulation and Directive (ARD) and recommendations from the Competition and Markets Authority (CMA) are drivers of activity but better explanation of what this means in terms of additional staff and the effect of passing back activities to professional bodies under the ARD would be helpful.
6. The reasoning for the proposed increase in reserves to six months' expenditure needs to be better explained. The government can introduce a statutory levy to fund the FRC and the sources of its funding are generally financially secure with good covenants.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you have any comments on the regulatory approach we are proposing for our new three year strategy?

7. Positive developments There have been positive developments in FRC activities relating to corporate reporting in recent years, which we welcome. In particular:
 - The development of the Financial Reporting Lab. This has proved to be a highly beneficial and innovative mechanism for encouraging best practice without new regulation.
 - While there will always be more to be done, the Corporate Reporting Review Panel has, in our view, made efforts to reflect the principles of the ongoing 'clear & concise' initiative, seeking to encourage the application of materiality and judgement.

8. One important benefit of finding better, non-regulatory ways of improving corporate reporting may be that it encourages the exercise of professional judgement and potentially reduces reliance on a box-ticking compliance mentality. In itself we believe this may encourage talented individuals to join and remain within the accountancy profession.
9. **Smaller listed and UK AIM companies** ICAEW commented in detail in August 2015 on the FRC's proposed plans to improve the quality of reporting by smaller listed and UK AIM companies as part of the recent FRC consultation process. Our response can be found [here](#). We also held a joint event with the FRC on the initiative in November 2015. We continue to support and encourage this initiative.
10. **Broadening the scope of the annual assessment of the quality of UK corporate reporting** ICAEW agrees generally with the proposed actions in relation to corporate reporting. The PPB states (page 15) that the FRC plans to broaden the scope of the annual assessment of the quality of UK corporate reporting. We think this should be expanded to explain what this means - a wider breadth of information reviewed, or an increased number of companies assessed – and the recognition of work and analysis already covered by others.
11. **EU Capital Markets Union** The scope of the important EU Capital Markets Union project is still evolving and the PPB will need to respond to this as it becomes clearer.
12. **Advance warning** The PPB describes (page eight) that the FRC is proposing, on a trial basis, to give a small proportion of companies advance warning that their annual report and audit will be reviewed, and where applicable to inform companies when the review has been completed and that the FRC does not intend to take any further action.
13. We broadly agree with this proposal as a useful step in promoting transparency and collaboration, but believe that the 'no further action' information should be communicated privately to companies as there would be the risk of this being interpreted as undue endorsement of a set of accounts were such information to be made public.
14. **Audit** ICAEW welcomes the proposals to transfer some of the audit practice notes and bulletins into the SORP regime, whereby the responsibility for maintenance is shared with CCAB members. This should make updating this guidance more responsive as well as reducing the calls on the FRC's resources.
15. **Defining audit regulation** The PPB (page 23) refers to "*rebalancing the costs of audit regulation so that they are met only by the audit profession*". We think it is important that the category of 'audit regulation' activities should be fully explained. Examples of current FRC activities reclassified under 'audit regulation' include ethical standards, guidance to audit committees and the effects of retendering and rotation.
16. Other than AQR and professional discipline activities which are already wholly funded by the profession, we think the case needs to be made why the costs of the reclassified activities are not shared across a wider range of stakeholders who also benefit from them.

Q2: Are there areas of our work where we could reduce the regulatory costs we impose without compromising the quality of corporate governance and reporting in the UK?

17. **Staffing** The FRC's staffing bill is set to increase by £1.5m in the 2016/17 budget. The PPB refers in several places to the need to recruit extra staff, but no explanation is given of how many staff will be recruited and the additional activities on which they will be deployed, in particular how many on 'audit regulation'.
18. **Approach** In particular, the costing of the need for additional AQRT staff to implement the CMA's recommendation of review frequency (page 16) could be better explained. A new performance indicator that "*By the end of the strategy period at least 90% of FTSE 350 audits will require no more than limited improvements*" is suggested on page 18. This could be a useful measure but it would be helpful to explain how this would be co-ordinated with the FRC's quite proper focus on reviewing audit firms, given that firms should be accountable for the quality of their audits as a whole.

Q3: Do you have any comments on the FRC's proposed projects and activities in 2016/17?

19. **UK GAAP** Many companies will be preparing their first set of financial statements under the new regime during 2016, with major changes to follow for small and micro entities. It would be useful for the FRC to clarify how it intends to assess the quality of reporting under the new regime, including monitoring any emerging issues and ensuring a smooth transition to the new accounting standards for small and micro entities.
20. **Timing of interactions** We ask that the FRC be mindful of the natural peaks in activity for its accounts preparers and auditors, notably the end of January tax filing deadline and the early year "busy period" in seeking responses to consultations.

Q4: Are the proposed indicators helpful in assessing progress towards the FRC's objectives; and are there other indicators that should also be taken into account?

21. **Relevant Research** There is good research available which considers the measures of success and progress for a regulator which needs to balance cost against good outcomes. For example, in its report, *Measuring Regulatory Performance, Evaluating the impact of regulation and regulatory policy, 2012*, the OECD sets out some suggestions on an approach to the creation of indicators to compare the results of regulation, including metrics such as cost effectiveness ratios and benefit-cost ratios.
22. **KPIs and measuring outcomes** We comment above (Q2) on the indicator of 90% of audits needing limited improvement and its relationship to the firms, whose processes and controls are under review. Some of the proposed indicators of success do not specify targets which will make it more difficult to judge whether the FRC has achieved all its ambitions.
23. In particular, we suggest a set of indicators in relation to regulatory costs (while maintaining a proportional regulatory framework) such as targets for disciplinary case cost management and time taken from receipt of complaints to the issues of formal charges.

Q5: Do you have any comments on our proposed budget for 2016/17?

24. **Developing financial priorities** There should be greater recognition in the PPB, in line with the Government's commitment to reduce the costs of regulation on business, of the need for financial priorities. This could include objectives to hold budget increases at inflation or lower, that increased responsibility costs in future years are offset by efficiency savings, or other mechanisms that demonstrate efficiency and value for money in disciplinary and investigation costs.
25. **Budget detail** The lack of detail in the PPB makes it difficult to appreciate how the FRC intends to allocate its resources between and across projects. This is of greater significance due to the reclassification of activities under 'audit regulation'.
26. **Impact of ARD** Several references are made to the additional workload brought on by the ARD and the need to increase AQRT staffing as result. However there is no reference to the transfer of some 1,200 audited entities from the FRC back to the RSBs, principally ICAEW. More detail is needed to understand the effect of this component on AQRT staffing and costs.
27. **Overheads** More clarity is needed on what is classified as 'overheads', together with indications of how these are managed and allocated with respect to the 'rebalancing' of costs to audit regulation. We understand that some 25% of the FRC's budget is accounted for by overheads.
28. **Reserves and security of funding** The PPB states an intention to hold six months of reserves. We think the case needs to be made for this increase. Six months reserves is higher than the level generally held by the professional bodies and would represent a permanent transfer of funds from those bodies to the FRC. Those bodies are generally financially secure with good covenants. If these reserves are held to be required in the event of a winding-up then there will be a range of options to meet any obligations.
29. The PPB states (page 23) "*There is a reserve power in companies legislation to introduce a statutory levy in the event that becomes necessary, but this would require Government action and time to put in place*". If this is a concern, work should be done to simplify this process.
30. **Directors' fees** The PPB includes £1.5m in Directors' fees (page 22). The 2015 Annual Report and Accounts disclose that £656,000 was paid to non-executive directors. It would be helpful to compare this with similar institutions.

Q6: Do you have any comments on our proposed funding requirement for 2016/17?

31. **The FRC's 2016/17 budget is presented as being in line with 2015/16 budget**, but there is actually an increase of £2.4m (7.7%) from the current financial year forecast. We think such an increase should be more clearly justified in an environment where inflation is low, the professional bodies' fee growth is similarly limited and there is pressure from government to reduce the costs of business regulation.
32. **High quality audit in the public interest** There has been debate in the past on who benefits from – and should contribute to – the FRC's activities and this is recognised in the PPB in the objective to promote "*high quality auditing in the public interest*". With this in mind, we urge a reconsideration of the proposed costs apportionment as many interested groups benefit from a strong audit profession. The proposed separation makes it appear that preparers have no interest in the process.

33. **Measuring value** There is no cost-benefit or impact analysis in the PPB for increased FRC AQRT activity. Such analysis would be useful particularly in terms of taking into account the extra costs on audit firms which will ultimately be passed on to clients/consumers.

Q7: Do you agree with our proposed levy rates for 2016/17?

34. Given our earlier comments on re-balancing, we suggest that the levy should be reviewed in the context of the benefits to a full range of parties from a robust audit profession.