



FINANCIAL REPORTING COUNCIL

PLAN & BUDGET 2006/07

DECEMBER 2005



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One - Introduction

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

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 revised Regulatory Strategy (version 2), which can be found on our website at www.frc.org.uk, provides the context for this Plan & Budget. The revised Strategy reflects our experiences in the first two years of our new responsibilities. The main changes are:

- recognition of the increased importance of international developments which affect corporate reporting and governance in the UK
- sharper focus in the work streams through which we pursue our objectives - and which form the basis for our major activities and projects in 2006/07
- changes in our internal management arrangements.

In the Strategy we explain that our work in pursuing our aim is organised around five core 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. Our organisational structure is shown in Annex A. A list of the abbreviations used in this document is provided in Annex C.

This Plan & Budget sets out the major activities and projects we propose to undertake in the 12 months starting in April 2006 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.

From April 2006 it is intended that the FRC will assume responsibility for actuarial standards and regulation as recommended by the Review of the Actuarial Profession conducted by Sir Derek Morris, whose recommendations have been accepted in principle by the Government. At the time of finalisation of this document the FRC is still consulting on and finalising various aspects of the implementation of these new responsibilities. An outline of our planned approach to our actuarial responsibilities is shown in Annex B.

We welcome feedback from interested parties on any aspects of our proposals. It would be helpful if comments could reach us by 28 February 2006. Contact details are provided in Annex D.

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 2006.

Two - Key features of the Plan & Budget

In preparing our Plan & Budget for 2005/06, we were very conscious that it would be a year of major change for many companies, their shareholders and auditors, with the introduction of international accounting standards, the OFR and revised auditing standards. In the circumstances, reflecting a clear message from our stakeholders, we did not propose any major new initiatives for the year, but planned to make further progress in two key areas: implementing the additional responsibilities we had been given by the Government; and helping to shape EU and international policy proposals.

Many of the regulatory developments in the past few years will still be at the early stages of implementation as we start 2006/07. Examples include IFRS, the amended requirements for narrative reporting, and the new ethical standards for auditors. As a result we believe that it remains appropriate that we avoid imposing significant new burdens on companies and their auditors in 2006/07.

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. An important feature of our work in 2006/07 will be taking an active role in helping to shape these proposals, 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. We will seek to ensure that, as far as possible, these proposals contribute to confidence in corporate reporting and governance, are proportionate to the issues they address, and do not impose unnecessary burdens.

The key features of our Plan & Budget for 2006/07 are that we intend to:

- **Lead public debate in the UK on the major issues affecting future confidence in corporate reporting and governance**, including:
 - o the significance of "true and fair view"
 - o a framework of the key drivers of audit quality
 - o concentration and competition in the audit market
 - o an appropriate strategy for convergence of UK accounting standards with IFRS
 - o best practice in narrative reporting.

- **Shift our resources from developing UK standards and guidance towards the development of high quality international standards and effective cross-border regulatory co-operation**, including:
 - o the IASB/FASB conceptual framework for financial reporting and convergence programme
 - o the IAASB Clarity project
 - o co-operation between national audit regulatory authorities
 - o the European Commission's Company Law Action Plan.

- **Monitor corporate reporting and governance practices in the UK and take enforcement action where appropriate**, including:
 - o reviewing annual and interim accounts
 - o monitoring audit quality
 - o operating an independent investigation and discipline scheme to deal with misconduct in the accountancy profession.

- **Contribute to modifying the UK regulatory regime to take account of changes in European and UK legislation**, including:
 - o the 8th Company Law (Auditing) Directive
 - o the 4th and 7th Company Law (Accounting) Directives
 - o the Transparency Directive
 - o the Company Law Reform Bill.

Our Strategy commits us to being a risk-based and proportionate regulator. We have sought to live up to that commitment by proposing a budget for core operating costs in 2006/07 which represents an increase of 2% over the budget for 2005/06 in cash terms but which is flat in real terms. A delay in reaching our target staffing level means that we now expect to spend £9.3m on core operating costs in 2005/06. The budget for 2006/07 represents an increase of 13% over the forecast for 2005/06.

The proposed scope of activities of our AIU in 2006/07 completes the transfer of responsibility for inspection of the audits of entities in which there is a major public interest from the professional accountancy bodies to the AIU.

In 2005/06, following consultation, we introduced a fairer basis for calculating the levy on listed companies, which meant that the majority of listed companies paid a lower amount than they would have done in 2004/05. We propose to calculate the 2006/07 levy on the same basis. Our proposed budget should mean that the levy will be set at a level close to that for 2005/06 but the final rates will depend on the number and size of companies who pay the levy. We will keep under review the issue of whether other publicly traded companies should contribute to the costs of our work.

Three - Major activities and projects

This section sets out the major activities and projects which we propose to undertake in pursuit of our aim in 2006/07. The sequence of material follows the objectives and work streams (shown in bold) set out in version 2 of our Regulatory Strategy.

Objective 1 - Promote high quality corporate reporting

a) Promoting the development of high-quality international accounting standards

- Influence the joint IASB/FASB project to develop a conceptual framework for financial reporting, and the convergence projects being taken forward under the Norwalk Agreement.
- Work within the EU to ensure appropriate European influence in the development of international accounting standards and their adoption in the EU.
- Contribute to IASB projects, including:
 - o Leasing (on which the UK has the lead)
 - o Management commentary.
- Undertake a research project into accounting for pensions.

b) Maintaining a high quality regime for UK accounting standards, including appropriate convergence with international standards

- Finalise a strategy for convergence of UK standards with IFRS.
- Continue work on the implementation of UK standards based on IFRS.
- Review the future role of the UITF in the context of IFRS.
- Contribute as appropriate to the implementation of the Transparency Directive.

c) Promoting improved reporting in information accompanying financial statements, including through narrative reports

- Undertake a review of the quality of narrative reporting in company reports.
- Review best practice for the disclosure of pensions liabilities by UK companies in the context of the new regulatory regime for UK pension schemes.

d) Encouraging the preparation of corporate reports which give a "true and fair view" and comply with the relevant legal requirements and standards, including taking enforcement action where it is appropriate to do so

- Respond as necessary to the outcome of our August 2005 consultation on the implications of new accounting and auditing standards for the "true and fair view".
- Review a selection of annual and interim accounts, applying selection criteria based on industry sectors, specific accounting requirements and company-specific trigger factors. In 2006/7, we will focus on the implementation of IFRS, drawing on the results of our review of interim accounts to inform specific issue reviews, which will include pensions disclosures. We will continue to select accounts for review from the same priority sectors identified for 2005/06 - automobile, pharmaceutical, retail, transport and utility. However, we intend to widen the focus by including some companies who provide services to these sectors.
- Respond to matters drawn to our attention as a result of complaints or public comment, encouraging referrals from the investment community, other professional advisers and elsewhere.

Objective 2 - Promote high quality auditing

a) Promoting high quality international standards on auditing

- Contribute to the IAASB "Clarity Project" to improve the quality of ISAs.
- Contribute to the revision of individual ISAs, including:
 - o related parties
 - o developing a new ISA on group audits.

b) Maintaining a high quality regulatory regime for auditing in the UK, including issuing appropriate technical and ethical standards, monitoring the supervision by the recognised professional bodies, and promoting an effective market for audit services

- Develop and issue for public consultation a paper on a framework of the key drivers of audit quality.
- Consider with the DTI the appropriate policy response to the research into concentration and competition within the audit market.
- Prepare for the implementation of the 8th European Company Law Directive:
 - o Work with the DTI to establish and action secondary legislative requirements for the effective implementation of our delegated powers - including requirements for transparency reports under Article 38, and requirements for the audit register, including for non-Member State auditors

- o Develop and establish procedures for the registration and regulation of non-Member State auditors of non-Member State companies
 - o Participate in arrangements for the co-ordination of the regulation of audit and the oversight of the auditing profession in the EU.
 - Promote arrangements for international co-operation and co-ordination between independent audit regulatory authorities across the world.
 - Monitor the passage through Parliament of the Company Law Reform Bill, and prepare for its implementation.
 - Update documentation of the regulatory processes of RSBs and RQB's and test compliance with regulatory processes through monitoring visits.
 - Update industry-specific auditing Practice Notes to take account of the implementation of ISAs (UK and Ireland), including those on charities, pension schemes, banks and building societies, insurers, investment businesses and friendly societies.
- c) 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**
- Undertake inspection visits to the 9 largest audit firms to review firm-wide procedures and specific audits, and issue recommendations to improve audit quality.
 - Review a selection of specific audits of public interest entities, including for the first time, entities not audited by the 9 largest audit firms, and issue recommendations to improve audit quality. The expansion of the coverage of audit inspections in 2006/07 completes the implementation of independent audit inspection as envisaged in the DTI Review of the Regulatory Regime of the Accountancy Profession published in January 2003.
 - Publish an annual review of findings from our independent monitoring regime.

Objective 3 - Promote high standards of corporate governance

- a) Promoting high standards of corporate governance in the UK based on the "comply or explain" approach, maintaining an effective Combined Code on Corporate Governance, and related guidance, and promoting its widespread application.**
- Consult on and implement the amendments to the Combined Code proposed following the 2005/06 review.
 - Support the Pre-emption Group in producing, promoting and monitoring the application of revised Pre-emption Guidelines.

b) Promoting a non-prescriptive EU approach to corporate governance that shares good practice and promotes the development of effective national regimes.

- Work with the DTI to implement EU requirements on audit committees and corporate governance statements in a manner consistent with the existing UK framework.
- Influence the development and implementation of the European Commission's Company Law Action Plan, including the proposed directive on shareholders' rights.
- Share experience and best practice with bodies responsible for corporate governance codes in other countries.

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

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

- Monitor developments within the financial reporting framework, assessing those issues that could adversely affect public confidence in accountancy - and where appropriate undertake more detailed research and make recommendations to the professional bodies or recommend the development of new standards.
- Follow up recommendations from 2005/06 projects on:
 - o the training and education of accountants
 - o the accountancy and auditing needs of small and medium-sized enterprises.
- Publish an annual report on 'Key Trends' within the accounting profession.

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

- Hold the hearing of the Mayflower case.
- Continue the investigation into the conduct of Deloitte & Touche LLP as auditors and advisers to the MG Rover Group.
- Continue to monitor and investigate other matters which raise or appear to raise important issues affecting the public interest.

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

- Finalise Ethical Standards for Reporting Accountants.

Objective 5 - Promote our effectiveness as a unified independent regulator

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

- Report on our performance by publishing our Annual Report for 2005/06, which will include a report on the way we have sought to meet the principles set out in our Strategy.
- 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.
- Make ourselves open to scrutiny by holding an Open Annual Meeting.
- Publish and invite comments on our Plan & Budget for 2007/08.

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

- Implement enhanced arrangements to consult and engage with our stakeholders, including holding a corporate reporting and governance conference.
- Work with the DTI and HM Treasury to ensure that appropriate information "gateways" are in place between us and other regulatory authorities in the UK and other countries.
- Review our relevance to the public sector.

c) Ensuring that we have adequate resources and management processes

- Review the effectiveness of our arrangements for identifying and responding to risks to confidence in corporate reporting and governance in the UK.
- Develop our people management and development processes to improve our ability to attract, retain and motivate the people required to meet our objectives.
- Develop our IT systems to improve our effectiveness and efficiency, in particular in relation to risk assessment and document management.
- Improve our resilience in the event of incidents which disrupt our normal operations.

Four - Expenditure and funding

Financial Management and Reporting Framework

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 costs:

- 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 Court. 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. The other costs of the FRRP (principally staff, office accommodation and shared IT systems) are included in core operating costs.

Summary of expenditure

	Budget 2006/07	Forecast 2005/06	Budget 2005/06
	£m	£m	£m
Core operating costs	10.5	9.3	10.3
Audit inspection costs	2.5	1.7	2.2
Investigation and Disciplinary Case costs	0.5	0.7	-
Review Panel Case costs	-	-	-
	13.5	11.7	12.5

Core operating costs

The proposed budget for core operating costs for 2006/07 is £10.5m, an increase of 2% over the budget for 2005/06. The forecast for 2005/06 reflects slower than planned recruitment of appropriately qualified staff.

Analysis by category of expenditure:

	Budget 2006/07	Forecast 2005/06	Budget 2005/06
	£m	£m	£m
Staff costs	7.2	6.2	6.6
Accommodation costs	1.1	1.0	1.1
Professional fees	0.7	0.7	0.7
IT costs	0.5	0.6	0.5
Other costs	0.9	0.7	1.1
Contingency	0.3	0.3	0.3
	10.7	9.5	10.3
Sundry income	(0.3)	(0.4)	(0.2)
Capital expenditure	0.1	0.2	0.2
	10.5	9.3	10.3
Staff numbers	61	50	59

The increase in budgeted staff costs reflects an increase in headcount from 59 to 61 and the need to offer rewards which will attract and retain staff with the skills and experience needed to ensure that our work is of high quality. The contingency provides a modest allowance for activities and projects which had not been identified by the time this plan was finalised.

Analysis by operating unit

	Budget 2006/07		Forecast 2005/06		Budget 2005/06	
	£m	Staff	£m	Staff	£m	Staff
ASB	2.5	16	2.2	14	2.7	15
APB	1.2	7	1.0	6	1.3	7
FRRP	1.7	11	1.5	8	1.9	11
POBA	1.3	7	1.1	6	1.2	7
AIDB	1.0	5	0.7	4	0.9	4
CGU	0.1	1	0.1	1	0.1	1
Support Services	1.5	9	1.8	7	1.0	8
Corporate	1.2	5	0.9	4	1.2	6
	10.5	61	9.3	50	10.3	59

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 proposed distribution of resources is substantially unchanged from the budget for 2005/06.

Audit inspection costs

The only other category of activities which is susceptible to normal budgetary limits is audit inspection. The budget for the AIU is £2.5 million, which is the cost of meeting the programme of independent audit inspections discussed under Objective 2(c). The AIU is planning to operate with 17 staff in 2006/07 compared to a forecast of 12 in 2005/06.

Investigation and disciplinary case costs

The budget includes only a provisional estimate of the currently foreseeable costs that are likely to be incurred in 2006/07 in relation to the two cases which have already been announced, Mayflower and MG Rover. The disciplinary hearing in respect of the Mayflower case is expected to be concluded in 2006/07. The investigation in relation to MG Rover is underway but it is uncertain when it will be completed. The costs of these two cases may be higher than this estimate. If other cases arise they will involve additional expenditure for which no allowance has been made in the budget.

The levy on listed companies for 2006/07

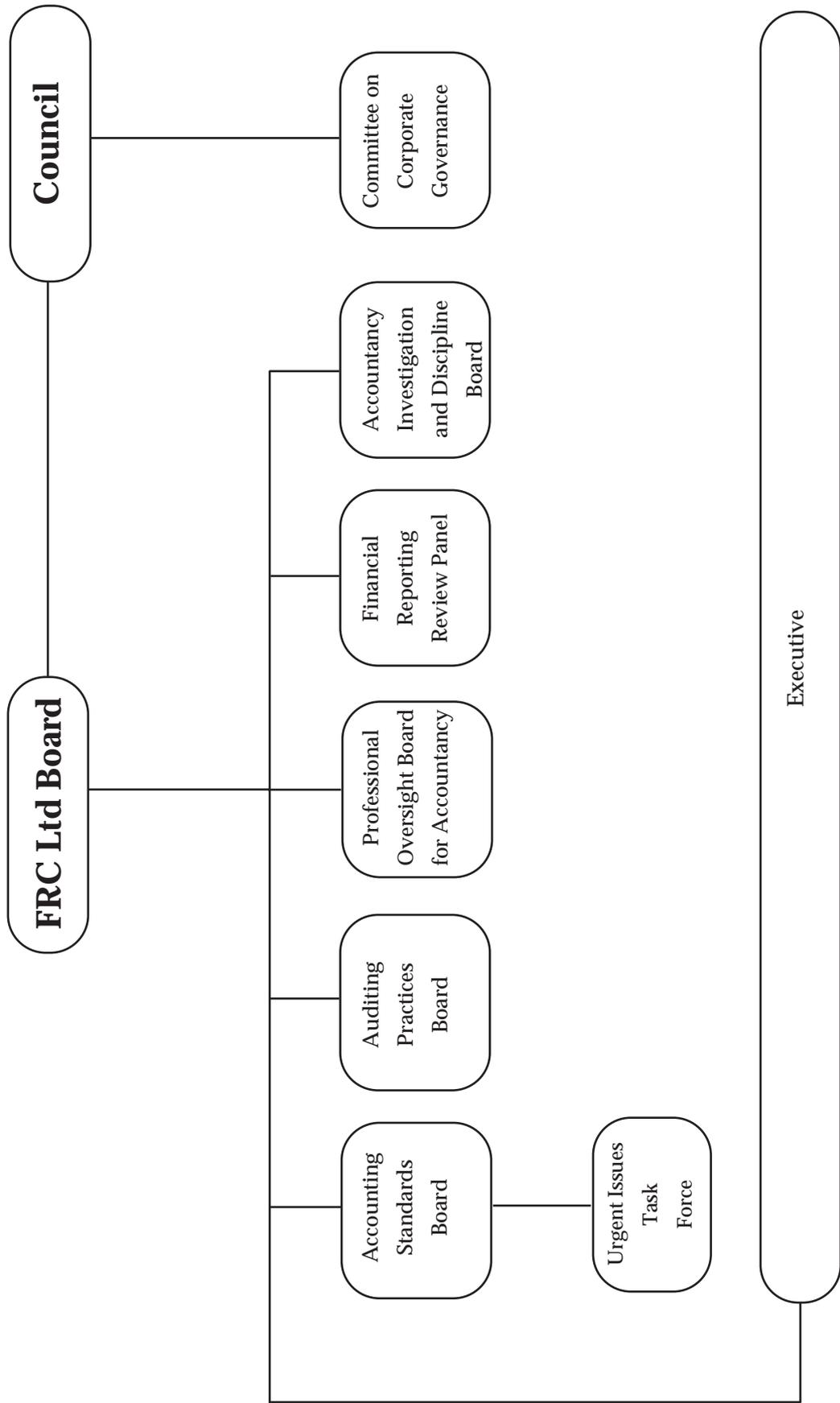
The levy on listed companies is collected on behalf of the FRC by the FSA at the same time that it collects its own fees, which helps to reduce the costs of collection.

In 2005/06, we changed the basis of our levy from flat fees to a levy based on market capitalisation. We propose to calculate the levy for 2006/07 on the same basis.

Our proposed budget should mean that the levy will be set at a level close to that for 2005/06 but the final rates will depend on the number and size of companies who pay the levy. We will publish a consultation paper on our levy proposals for 2006/07 in January 2006.

We will keep under review the case for extending our levy to include other publicly traded companies to which our activities apply.

Annex A - Organisational structure



Annex B - Actuarial standards and regulation

The FRC has been asked by the Government to take on a new role in setting actuarial standards and overseeing the regulatory activities of the actuarial profession. We are planning to start to implement our new responsibilities from April 2006.

Details of our plans, including our consultation document on funding the new regime, are available on our website.

The Company Law Reform Bill contains draft clauses that will provide the FRC with statutory immunity in relation to our new responsibilities and the power to raise a levy to fund them.

Major projects and activities in 2006/07

Our objectives for our work in relation to actuarial standards and regulation have yet to be finalised but are likely to focus on:

- promoting high quality actuarial practice
- promoting the integrity, competence and transparency of the actuarial profession.

We plan to:

- establish a Board for Actuarial Standards (BAS) to set the technical standards that will apply to actuaries
- expand the remit of POBA to oversee the profession's regulatory activities, including education and continuing professional development, ethical standards and disciplinary procedures
- introduce a scheme to extend the scope of the AIDB's investigation and discipline arrangements to members of the actuarial profession.

The cost of the new regime

Our consultation document explains that the costs associated with the new regime are likely to fall into the three categories set out below:

The FRC's "actuarial" operating costs

The actuarial operating costs will cover:

- the BAS (likely to be the largest element of the operating costs)
- the additional work undertaken by POBA and the AIDB
- a proportionate share of the FRC's overheads (which will increase by a modest amount as a result of the new arrangements).

These costs will be subject to firm budgetary limits.

The costs of actuarial investigation and disciplinary cases

Actuarial investigation and disciplinary case costs will depend on the number and complexity of cases, and cannot be subject to firm budgetary limits.

The recovery of the FRC's set-up costs

The FRC will incur set-up costs arising from the need to establish the new arrangements and recruit new operating body members and a small number of additional FRC staff. The consultation paper on funding noted that these costs could be in the order of £750,000. The FRC intends to recover them over the first three years of the operation of the new arrangements.

Reserves

We intend that a separate reserve built up from the actuarial funding arrangements will be held in relation to the FRC's responsibilities for actuarial standards and regulation. The Directors will make a judgement on the appropriate level of the reserve in preparing the Plan & Budget 2007/08.

Summary of Expenditure in 2006/07

The consultation document noted that the total cost of the new arrangements in 2006/07, including the initial contribution to the actuarial investigation and disciplinary case costs fund and the recovery of set-up costs, is estimated to be as follows:

	£m
Actuarial operating costs	1.3
Initial contribution to the actuarial investigation and disciplinary case costs fund	0.3
Recovery of set-up costs	0.2
	<hr/>
	1.8
	<hr/> <hr/>

Funding the new arrangements

With the support of HM Treasury, the FRC proposes to meet the costs of the new arrangements through an annual contribution from the actuarial profession and a levy on insurance companies and the pension industry.

Implications for the FRC's overall expenditure

On the basis of the estimated costs set out in our consultation document on funding for our responsibilities for actuarial standards and regulation, the FRC's overall expenditure in 2006/07 would be as follows:

	Budget 2006/07 £m	Forecast 2005/06 £m	Budget 2005/06 £m
Accounting, auditing and corporate governance			
Core operating costs	10.2	9.3	10.3
Audit inspection costs	2.5	1.7	2.2
Investigation and Disciplinary Case costs	0.5	0.7	-
Review Panel Case costs	-	-	-
	<u>13.2</u>	<u>11.7</u>	<u>12.5</u>
Actuarial standards and regulation			
Core operating costs	1.3	-	-
Initial contribution to the actuarial investigation and disciplinary case costs fund	0.3	-	-
Recovery of set-up costs	0.2	-	-
	<u>1.8</u>	<u>-</u>	<u>-</u>
	<u>15.0</u>	<u>11.7</u>	<u>12.5</u>

The core operating costs of actuarial standards and regulation include a fair apportionment of our support services and corporate costs (£0.3m). As a result, the core operating costs of our work on accounting, auditing and corporate governance would be £0.3m lower than they would be if we did not take on our proposed actuarial responsibilities.

Annex C - Abbreviations

AIDB	Accountancy Investigation and Discipline Board
AIM	Alternative Investment Market
AIU	Audit Inspection Unit
APB	Auditing Practices Board
ASB	Accounting Standards Board
BAS	Board for Actuarial Standards
C(AICE)	Companies (Audit, Investigations & Community Enterprise) Act
CGU	Corporate Governance Unit
DTI	Department of Trade and Industry
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FSA	Financial Services Authority
HMT	Her Majesty's Treasury
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ISA	International Standard on Auditing
OFR	Operating and Financial Review
POBA	Professional Oversight Board for Accountancy
RQB	Recognised Qualifying Body
RSB	Recognised Supervisory Body
SFO	Serious Fraud Office
UITF	Urgent Issues Task Force

Annex D - Contact details

Comments on the Plan & Budget for 2006/07 should be sent to:

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For general information about the work of the FRC, please see our website at: www.frc.org.uk

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