6 March 2014

Mr David Andrews
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Dear Mr Andrews

THE FINANCIAL REPORTING COUNCIL (FRC) DRAFT PLAN & BUDGET AND LEVY PROPOSALS 2014/15

Introduction

CCAB welcomes the opportunity to comment on the above consultation document issued by the FRC in December 2013.

About CCAB

The combined membership of the five CCAB bodies – ICAEW, ACCA, ICAS, CIPFA and Chartered Accountants Ireland – amounts to 245,000 professional accountants in the UK and the Republic of Ireland (354,000 worldwide).

CCAB provides a forum for the bodies to work together collectively in the public interest on matters affecting the profession and the wider economy.

CCAB's credibility stems from its insight into all areas of finance and accounting, from finance director and audit partner to management accountants, professional advisers, public sector finance leaders and entrepreneurs. CCAB's members work through the financial value chain in all sectors as key decision makers and business leaders within the UK and around the world.

General

The draft plan makes reference to proportionality throughout, including within its key priorities, its core values, and its budgetary considerations. We particularly welcome the clear statement within the FRC's regulatory approach that 'while recognising that the public interest is wide, we have to set clear priorities so that we can use our resources effectively and efficiently; and can be proportionate in all our work - ensuring that we do not impose inappropriate burdens on business'.

With regard to oversight, as with all aspects of regulation, this approach is undoubtedly appropriate. Nevertheless, the experience of the professional bodies in the past has been that it has not always translated into practice, and proportionality has not always been apparent as a priority.

Total costs are forecast to exceed budget by £3.0m in 2013/14 and then increase by a further £4.7m. Whilst we accept that there are external pressures on the FRC, we do question if, in a time of austerity and low growth, this increase can be justified. Of the £7.7m increase from the 2013/14 budget to the 2014/15 budget the accountancy profession's contribution will be an additional £6.3m (49%). We are concerned that this does not accord with the principles of good corporate governance and note that it will be difficult for the professional accountancy bodies and their firms and members to budget and operate in this environment. With this proposed increase in the accountancy profession's contribution, we should expect corresponding plans to enhance accountability to those that are funding the FRC. Further, if Government and regulators require the FRC to take on more activities, it follows that the funding arrangements, including the contribution of Government itself, may need to be reviewed; we cite the implementation of the Competition Commission recommendations as one example.

Yours sincerely

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Our Reponses to the Consultation Questions

Q1. Do you agree with the FRC's assessment of the current strengths and weaknesses of corporate governance and reporting in the UK?

We concur with the corporate reporting issues raised of excessive clutter and lack of clarity in financial statements, and we support a continuing focus on resolving those issues. We also concur with the need to improve reporting quality by smaller listed and AIM companies. It would be useful for the FRC to provide further details on its initial thinking on what such a project would involve. We provide comments to Question 2 below on how we believe these issues should be prioritised.

The consultation document states that '[t]he quality of governance amongst larger UK companies is generally sound'. We fear this may be complacent and indicative of a regard for compliance and disclosure practice over demonstrable quality. Recent evidence indicates that there remains an entrenched view among large companies that good governance means observing the letter of guidance rather than acting in accordance with its underlying purpose. We suggest that the FRC commits to considering the outcomes of governance guidance; in particular whether the guidance in the code is sufficient to enhance the quality of governance in the interests of all relevant stakeholders.

We endorse the concern to enhance the extent and quality of engagement on the part of investors, and consider that this area of activity requires an effort to improve both reporting by companies and involvement by investors.

With regard to the assessment of current economic and market context, we should also point out that, while investors are put off the equity markets for a number of reasons, one of the main reasons that puts off companies is the cost and burdens associated with obtaining a listing. The recent Kay report highlighted the dramatic decline in companies coming to market. Since part of the FRC's declared mission is to foster investment, it should adopt a clear focus on making listing a more attractive proposition for both companies and investors, working as necessary to influence European legislation.

The first paragraph of Regulatory Approach (page 4) refers to a wide stakeholder group. Given the large area of responsibility of the FRC this is not an unreasonable list, but such a wide duty of care does not apply in the delivery of audit itself where the duty of care is confined to shareholders as a body. Regretfully in other pronouncements the FRC seems to be blurring the edges; the possible consequence is that the FRC will do more in the inspection regime than it should to satisfy Companies Act obligations. This will have ramifications for costs and this budget.

We do not necessarily question, at this stage, the aspiration to widen the duty of care. But the FRC should seek to achieve this aspiration through the due process of Parliament and the education of the insurance market. Otherwise, the funding of the industry will feel unstable with what may be seen as a 'bottomless pit' opening up at the expense of the accounting profession. In the meantime, we suggest that the FRC should be tighter in its mission and strategy around duty of care.

Q2. Do you agree the proposed priorities? (Noting that the FRC is preparing for a number of additional activities that it is expected to be required to undertake as a result of changes in European and UK law and Competition Commission proposals for enhanced audit inspections)

We generally support the proposed priorities, especially the emphasis on improving the audit of banks, and the focus on audit quality and the value of audit. The implementation of the Competition Commission recommendations and the EU audit reform package will also be key issues.

Generally, the lack of detail in the budget makes it difficult to ascertain how the FRC intends to allocate its resources between projects/areas but, taking the view that the FRC is primarily a regulator, and this role is complemented by appropriate research and forward-looking outputs, we set out below our views on which aspects of the FRC's work have higher or lower priorities in certain areas:

Higher priority – corporate reporting

- Risk-based monitoring and communicating the findings thereof. Securing improvements in key problem areas identified (being currently, the need for improvements in reporting by smaller listed companies).
- Monitoring the initial implementation of FRS 100, 101 and 102 (being early adoption of the Standards during 2014/ 15, and consequently perhaps only a low-key responsibility in that year but a higher priority thereafter), and preparing for the implementation of new EU requirements (via the Accounting Directive, and the revised SORPs.
- Narrative Reporting and cutting clutter, where this involves collaboration with other bodies such as the IASB and BIS, or develops important current initiatives such as the Integrated Reporting Framework. We support the involvement of the Financial Reporting Lab in this work, as its outputs to date have generally attracted positive comments.

Higher priority – oversight, monitoring and enforcement (with regard to corporate reporting)

- Continue to deal in a timely manner with supervisory issues and to clear outstanding investigations, as this will maintain confidence in the regulatory process.
- Preparing for the implementation of new EU requirements and Competition Commission recommendations.

We would caution that an increase in the volume of monitoring of PIE auditors will not necessarily enable the Audit Quality Review Team to draw conclusions on a firm's overall audit quality. The sample sizes of audits inspected will be too small to draw such conclusions. A report that lists a number of weaknesses may serve as an indicator that the firm's standard of audit work is low; but a report noting few deficiencies cannot be taken as sound evidence that standards are high. Therefore, such reports would be unlikely to assist choice in the audit market.

Lower priority – corporate reporting

- To influence routinely the IASB's agenda, if the IASB then aims to take on projects it is unlikely to be able to deal with. (The IASB has limited resources, and many regulators across the world will be making similar representations.)
- Initiatives not in response to an identified need. (Sufficient 'pure research' of this type is carried out by academic organisations.)

With regard to oversight the merging of findings from corporate and audit quality reviews blurs the duty of care lines of responsibility referred to under Question 1 above.

The reference to the inspection of third country auditors makes no reference to assessing equivalence and restricts making the physical trips where equivalence cannot give the assurance. There is no reference to risk or materiality in the context of overall markets. This may be an issue of drafting.

Some activities outlined in the updated work plan lack sufficient detail to allow us to comment meaningfully on the intentions of the FRC. For example, 'Harness the implementation of UK GAAP as a means of addressing the standard of reporting by non-listed entities': it is not entirely clear what is meant by this or what it would involve. Also, 'Consider the role and use of discount rates in financial reporting': it would be useful to understand whether this interacts, and if so how, with the IASB's research project on discount rates.

Other examples where more detail would be beneficial include:

- Influencing the IFRS debate - the draft plan refers to FRC plans to continue influencing the IASB on the conceptual framework, post implementation of IFRS 3 Business Combinations, cashflow reporting and discount rates. However, there is no mention of its plans to advise the IASB more actively through its Accounting Standards Advisory Forum, or indeed the debate that has developed in Europe on IFRS.
- EFRAG - the draft plan makes no reference to the FRC responses to the many bulletins and papers issued by EFRAG.
- Integrated Reporting - there is very little reference to the International Integrated Reporting Council framework and the activities, if any, the FRC should be pursuing.
- Practice Notes and Bulletins – we should welcome a clear statement as to the FRC's view of their responsibility for these documents going forward.

There are references in the consultation document to thought leadership in particular about the quality and value of audit. We hope that the FRC will continue to work with the specialist teams within the CCAB bodies to avoid duplication and, therefore, avoid increased costs.

Q3. Do you have any comments on our proposed effectiveness indicators?

As indicated in response to Question 1, there is a risk that the FRC might have a regard for compliance and disclosure practice over demonstrable quality. Measuring statistical compliance with the letter of guidance is an incomplete indicator of the quality of governance practice. While it is reasonable to expect companies to follow whatever guidance they are supposed to adopt, and therefore to take compliance into account, it would be helpful if the FRC developed alternative mechanisms which would give a more outcomes-orientated impression of how governance had enhanced business performance or the quality of engagement.

More generally, we have concerns that the proposed effectiveness indicators are not framed around 'SMART' outcomes. Therefore, they do not help to demonstrate due regard for the regulatory principle of accountability. For example, phrases such as 'demonstrating further progress' and 'continue to work closely with' do not point to clear benchmarks.

Corporate Reporting

- These are mostly agreed, including the proposed work to assess how influential the work of the Financial Reporting Lab is.
- The assessment of how IFRS are meeting user needs will be of use where it provides relevant input for the IASB.

Oversight, monitoring and enforcement (with regards to corporate reporting)

- The indicator 'demonstrate further progress in managing effective supervisory enquiries' could be made more precise by, for example, setting timescales for the conclusion of the initial investigatory work.
- There needs to be a further effectiveness indicator for monitoring (such as stating a target for further improvements in quality) and better reporting by smaller listed companies (although it is acknowledged that improvements will only become generally apparent after one year).

As this consultation includes budget and levies and the FRC's costs are increasing, it would be useful if the FRC could add a range of effectiveness indicators related to financial control and value. These could include for example:

- Business case analysis and independent evaluation of value for money on behalf of the funders, in particular the controlled expansion of the AQR.
- Greater transparency in annual reporting and future consultations on cost versus return particularly in the areas of proposed budget increase in this period.
- Assurances and confirmation of oversight that any spend external to the FRC has been tendered effectively, with conclusions as to how this secured best value.

Key indicators of effectiveness should be worded so as to ensure that the coverage is achieved by both the FRC and the RSBs so that the best use of resource is available in either.

Q4. Are there any areas where you consider the FRC should reduce its activities?

Our response to Question 2 mentions lower priority areas in which the FRC could reduce its activities. These relate to work intended to influence but which is not likely to be taken further, and research on issues in relation to which it is uncertain that a wider debate will arise.

Q5. Do you have any comments on our proposed budget for 2014/15?

The overall budget for core operating costs shows another increase above general inflation. Even with the anticipated additional accommodation costs (which are not quantified in the Draft Plan), continuing increases of this type are liable to be questioned. Our answers to Questions 2 and 4 above indicate areas in which activities might be reduced, and costs controlled. In addition, the FRC should be able to demonstrate that it can control budget increases through efficiency savings. With this in mind, we again applaud the stated approach that we highlighted under 'general' in our covering letter.

Until 2011, the FRC was of the view that it was obliged to cover in its inspection regime all 50 firms auditing PIEs. Those reviews were passed down to the RSBs (with their support) without any contraction of the budget. The EU has now blocked this so there is a proposed increase in the budget. There is an inconsistency here which needs explanation. Also, the new EU Directive/Regulation allows two years for implementation, and so we question the need to increase the budget in 2014/15.

On AQR costs, the reasons given for the 44% increase in the AQRT costs base for 2014/15 are the three-fold requirements of the Competition Commission review, new monitoring requirements from Europe and the impact of the Local Audit and Accountability (LAA) Act. As far as we are aware, none of these will require the immediate increase in monitoring activity in 2014/15 from AQRT which the 44% increase implies. In particular, the new requirements from Europe will have a two-year grace period and the first reviews by AQRT under the LAA Act will not commence until, at the earliest, after the close of the 2016/17 financial year. The AQRT currently performs similar work under a separately funded contract with the Audit Commission, and this is set to continue until the new regime comes on stream. In short, we should like to see a detailed phasing explanation of when the extra monitoring work will actually be carried out.

In the area of disciplinary costs, the 30% increase in disciplinary costs to £10 million is in fact a 50% increase on the 2013/14 FRC budget for this item. While the FRC argues that this is 'demand led' there is the fact that the caseload taken on by the FRC is, to a large extent, in its own gift – its new powers do not require any justification or accountability to another body as to why and when it will commence preliminary investigations or pursue a case through to tribunal. A review of the FRC's criteria for deciding what is a 'public interest' case, would be welcomed, and demonstrate due regard for proportionality, as we fear that there is a tendency for the FRC's interpretation of the criteria to be of the widest kind. We are also concerned, based on recent experience, that the Conduct Committee may be widening its reach into areas where it does not have a statutory basis, for example insolvency complaints. We should like to see a more transparent accountability mechanism that demonstrates efficiency and value for money in disciplinary and investigation costs.

In a slow growth economy and reflecting the environment in which those regulated must operate, we suggest that the FRC work to a budget for accountancy case costs, prioritising and focussing on getting the required work done to a financial target rather than planning to increase the budget year on year.

Q6. Do you have any comments on our proposed preparers levy rates for 2014/15?

The overall amount of levies reflects the FRC's proposed budget, which is commented on under Question 5 above. Between categories, larger companies face a higher percentage increase than smaller ones, despite the greater number of problems identified as needing attention in the latter group. However, to the extent that the identified problems reflect a lack of resourcing in the smaller companies, it would, realistically, be counter-productive to increase the regulatory cost burden on them to reflect the extra attention needed from the FRC.

Q7. Do you have any comments on our proposal further to align the FRC levy arrangements with the FCA Listing Fees?

We have no detailed comments on this, but note that in general, this proposal has the advantage of transparency and appears to have logic, given that both the FRC and FCA have a regulatory function.