



The Consultative Committee of Accountancy Bodies

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The Institute of Chartered Accountants in England and Wales
The Institute of Chartered Accountants of Scotland
The Institute of Chartered Accountants in Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Chartered Institute of Public Finance and Accountancy

By E-mail: planning@frc.org.uk

Dear David,

FRC DRAFT PLAN & BUDGET 2008/09

On behalf of my CCAB colleagues, please find attached our responses to the specific consultation questions in the Draft Plan and Budget 2008/9. We welcome the opportunity to comment and are supportive of the FRC's objective for a risk-based and proportionate approach. While the CCAB is generally supportive of the FRC Strategy, it hopes that the FRC will find our detailed comments helpful. We will continue to work with the FRC towards the achievement of the desired outcomes of proportionate, market-led regulation and oversight.

In brief, our main points are:

- The relationship between the FRC and the accountancy profession should be explained in the context of the regulatory environment.
- The accountancy profession should be defined in terms of its constituent bodies.
- The structure of the Plan & Budget, presented in two documents, results in duplication of information which may cause confusion; as a result the identification of issues and the work needed may not be as clear as it could be and there are certain inconsistencies between the two documents, especially in terms of identified risks.
- It may be helpful to distinguish those activities/projects that could be regarded as 'business as usual' from those considered as priorities/new projects.
- Key performance indicators (KPIs) and timescales should be applied to activities/projects wherever possible.
- Steps should be taken to ensure that the list of activities/projects is reflected in the work plans of the Operating Boards.
- We do not believe that the current level of audit market concentration means that the audit market is inefficient.
- We would urge the FRC to adopt a greater focus on fewer areas, guarding against regulatory change where there is no proven need and where there could be major unintended consequences.

- We have concerns about the increase in core operating costs and comments made about increases in future years in terms of value for money, control over future costs and extra resources being used for the FRC's international aspirations.
- We do not propose to comment on the FRC's levy proposals for 2008/09 but we note that this assumes that the accountancy profession and business will meet the shortfall in funding arising from the Government's decision to reduce the level of its contribution.

Yours sincerely,

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CCAB COMMENTS ON THE FRC DRAFT PLAN & BUDGET 2008/09

GENERAL

Relationship with the Profession

We believe that it would be helpful if, early on, in the Draft Plan and Budget clarity was provided with reference to the environment in which the FRC operates, including its interaction with the CCAB bodies who act as primary regulators of their members and firms under the oversight of the FRC. The consultation questions cover the assessment of major risks, but do not ask whether the components identified as contributing towards the achievement of the supporting outcomes are complete. In this respect, we note that Strategic Outcome Six (b) (iii) talks about effective working relationships with UK Government and other UK regulators, but does not mention effective working relationships with the professional bodies. It would also be helpful to identify where CCAB bodies, collectively or individually, may be involved in a task force or other type of group in order to drive a project forward.

Professional Bodies subject to FRC Oversight

There is a lack of definition in what is a publicly available document as to which bodies constitute the 'accountancy profession' and are subject to FRC oversight. We would suggest that the CCAB bodies are named together with their status as RQBs and RSBs as appropriate. We understand that for legal reasons it may be necessary to name organisations outside the CCAB which fall within the remit of the FRC even though they do not contribute to its funding. Clearly, if this suggestion were to be adopted, a similar definition would need to be provided for the actuarial profession.

CONSULTATION QUESTIONS

1. Will the approach we have developed provide a clearer view of the judgements we have made and be helpful in obtaining better feedback on our assessments?

We welcome the FRC's objective for a risk-based and proportionate approach and the goal of having a clearer basis for prioritising the FRC's work. We are also supportive of the transparency and level of detail within the Draft Plan and Budget and the Supplementary Information. Generally the new approach of applying scenarios to assess the achievement of outcomes is beneficial. However, does the present/downside/upside scenarios approach provide the clearest identification of the issues raised and the work needed? The meaning of the phrases '*significant concerns*' and '*serious shortcomings*' is not immediately clear and nor are the consequences for the FRC's work if these are the conclusions on particular areas. It is helpful to see in the supplementary information which operating arm of the FRC has lead responsibility for the activities/projects. However, we would question the approach as follows:

- The explanation of how the FRC has arrived at its assessment of major risks is contained in the Supplementary information which results in duplication of information between the two documents. There is also the possibility of confusion, as the process of establishing the strategic outcomes, supporting outcomes and components, and assessing the concerns and the major risks, resulting in the major activities and projects is not logical. The division of information between the two documents detracts from the logical flow of identifying the Strategic Outcomes through to identifying the major activities and projects. In general, it would be helpful to see one clear plan that identifies all activities with those seen as priorities being highlighted in some way.
- Due to the level of repetition between the documents, insufficient detail has been provided in respect of the actual activities and projects planned. Sometimes (for example when the Plan discusses concentration in the audit market), one has to read 'outside' the document to understand what the mitigating strategy is. (In this example, it simply refers to the 'recommendations made by the Market Participants Group'.) At the same time there are a significant number of activities/projects listed. Will the FRC be able to deliver on all these activities/projects and has the risk of non-achievement and impact been fully assessed?

- Some of the activities/projects appear to be “business as usual”. For example, in the supplementary information page 21, the activity/project listed is “statutory oversight of the regulatory processes of the RSBs and RQB’s...” It may be helpful to have the ‘business as usual’ activities separated out as simply ongoing, and highlight other activities and projects that are considered to be priority or new projects. (Note: These two abbreviations are not included in the list of abbreviations at Annex A).
- There are no KPIs or timescales attached to the activities/projects. Whilst it is recognised that applying KPIs may be difficult due to the nature of the FRC’s work and the reliance on market participants and other agencies, they should however be applied to those activities and projects where it is possible to do so. Some of the activities/projects as presently worded are very general and the application of KPIs and timescales would assist.

2. Will the publication of our assessments be helpful in highlighting the priority areas for action to contribute to the achievement of the outcomes defined in the Strategic Framework?

As stated in the comment on Question 1 above, it would be more helpful to have clear targets and KPIs connected to the Strategic Framework outcomes.

The publication of the assessments, together with the FRC’s bases for making its assessments, are useful communications to assist stakeholders in contributing to the consultation. Stakeholders should also be aware of their responsibilities in recognising risks and avoiding downside scenarios.

However, we refer again to the comments made earlier regarding the possible confusion that could arise through the amount of repetition and the structure of the documents. There is a danger that the focus of the FRC will be lost amongst the detail of how the assessments were made. It may be preferable to present only the top line risks externally. The methodology to arrive at those top line risks may still be used internally by the FRC and its Operating Boards to enable them to arrive at their conclusions.

3. Do you agree that our assessment of the achievement of the outcomes in our Strategic Framework, in the downside scenario, properly reflects the plausible risks?

We agree that the assessment of the achievement of the outcomes, in the downside scenario, properly reflects the plausible risks. However, it is not clear that the risks identified have been addressed. There are areas where the primary responsibility for achieving a Supporting Outcome does not rest with the FRC. Notwithstanding this, the assessment of the achievement of the outcome and the identified risk could highlight an area where the FRC could contribute. For example, Annex B to the FRC’s document ‘Regulatory Strategy: Our Role and Approach’ states that the APB’s functions include contributing to efforts to advance public understanding. The FRC clearly has a role to play in communicating responsibilities to other parties.

There are no controls applied to the risks. It would be helpful to see some controls where it is possible to apply them and also for a general statement to be included in the document as to how risk is managed by the FRC.

4. Do you have any comments on the detailed assessments of the risks to the achievement of the outcomes in our Strategic Framework included in our document Draft Plan 2008/09: Supplementary Information published on our website? Is there additional evidence which should be considered in relation to these assessments?

We are in broad agreement with the analysis of risks contained in the Supplementary Information document. However, as stated in the comments on Question 1 above, we are not convinced that this approach leads to the clearest identification of the issues and work needed.

Under Supporting Outcome One (b), it is noted that inappropriate regulatory requirements might threaten the adequate supply of skilled and experienced people willing to serve on Boards. Section Three of the draft Plan identifies the need for continuing improvements in the overall quality of disclosures by companies, but does not acknowledge the need to balance this with the need to encourage people to serve on Boards.

We also note, under Supporting Outcome Three (b), that ‘some audit firms have argued that a perceived increase in regulation might adversely affect retention levels within audit firms which could adversely affect the supply of audit professionals in the future’. This brings to the fore the need for clarity and effective communication. This is specifically a problem in SMPs, and has not been adequately addressed.

5. Are there any other outcomes in our Strategic Framework where you believe there are significant concerns or serious shortcomings in the downside scenario which we have not identified? Please explain the risks which have led you to believe this.

At top of page 12 in the main document it is stated that ‘The supporting outcomes for which we assess there to be significant concerns or serious shortcomings for either the present or downside scenarios are shown below, together with the main risks which have led us to this view.’ There is an inconsistency in the document between what are identified as major risks in section three of the main document and what are identified in the more detailed analysis in the supplementary information.

For example outcome One (c) has *significant concerns* attached to the downside scenario for all three components in the supplementary information but only One (c) (ii) is highlighted in the main report. It is not clear from the analysis why the FRC would see this as a more major risk than other two.

The first page of Section Three highlights concerns relating to recent credit market conditions, including the adequacy of disclosures relating to financing arrangements. These concerns have an impact on the risks identified under Strategic Outcome Two and the FRC’s activities in the area of corporate reporting. However, it is not clear that these concerns have been drawn out in sections Three and Four of the consultation.

Outcome Six (b) ‘The FRC is recognised in the UK and globally as independent, credible, authoritative and influential’ - Given the current climate, with predictions of a major corporate collapse and the likely consequential criticism of the auditing community and its regulators, it is surprising that this risk (or that of another unsuccessful finding in a high profile disciplinary action) are not cited as possible risks challenging this outcome in a Downside scenario. This is particularly the case given the statement on page 7 of the Draft Plan that ‘no system of regulation can ever eliminate the possibility of corporate reporting or governance failures.’

Further, it may be beneficial to highlight some of the bigger, longer term risks facing the FRC as if they were to materialise, there could be a potential impact on the activities, projects and budget for 2008/9.

6. Do you have any comments on the scope and relevance of the proposed major activities and projects included in the draft Plan for 2008/09?

It would be helpful to have more information on the FRC’s intended international activities both as a member of IFIAR and in its own right and the additional resources the FRC estimates that this will require. Also, to what extent will the FRC be engaging with the European concerns over IASB?

We feel that the proposed major activities and projects do not adequately address the impact on, or the implications for, SMEs but note that there is a proposal, in the discussion paper on Cost Effective Regulation published on 10 March, to provide a summary of FRC regulatory requirements which apply to SMEs.

Within the scope of the major activities of the FRC is its responsibility to respond to consultations and discussion papers issued by IFAC (and IAASB in particular) regarding non-financial reporting in respect of sustainability and emissions verification for example. We feel that this should be acknowledged within the Plan.

It would also be helpful to understand how the tracking of activities/projects is undertaken and what information will be provided to the CCAB (and other stakeholders) in this respect.

7. Do you have any comments on the more detailed list of activities and projects set out in the document Draft Plan 2008/09: Supplementary Information which we have published on our website?

Due to the manner in which the Draft Plan is explained by using two separate documents, the major activities and projects listed in Section Four of the Draft Plan are not clearly linked to the risks set out in Section Three. It appears that not all of the activities and projects identified in the Supplementary Information are included in section Four.

In the supplementary information, component (ii) of Supporting Outcome Two (b) includes the assessment that ‘with market encouragement, and provided that suitable guidance is maintained ...’ the outcome will continue to be largely achieved. However, the issue of such guidance has not been included amongst the activities noted.

We would seek assurances that the more detailed list of activities and projects set out in the Supplementary Information will be reflected in the same terms in the work plans of the Operating Boards. Specifically in relation to auditing, we are in broad agreement with the more detailed list but we are unclear how this list connects with the detailed APB work plan which will not be the subject of a formal consultation as it has in the past. The FRC should ensure that the work plans of the Operating Boards match the lists of activities and projects listed in the Strategy.

We have particular concerns relating Strategic Outcome Three: Auditing and the reference to the APB’s publication “Promoting Audit Quality” in terms of Supporting Outcome Three (a): *The legislative and regulatory framework provides clarity on the role and purpose of audit and the standards which auditors should meet.* In Component iv, *There is guidance on the key drivers of audit quality*, the downside is identified as auditors and audit committees not sufficiently embedding the guidance into their practices. The activities and projects suggest review of how the audit quality framework has been embedded and that “. . . the audit quality framework is embedded in the AIU's system for reviewing and reporting on audit quality”. This activity and project could be seen as promoting the FRC's framework to the level of a standard but, in fact, there are no regulatory or other requirements for firms or audit committees to adopt these drivers, even though they may have been identified as drivers of audit quality. We believe that this use of the results of a discussion paper as benchmarks for judging firms is inappropriate. In our view, the AIU should not embed the drivers into their monitoring approach.

8. Are there any additional activities or projects which should be included in the Plan for 2008/09 or for future years?

We believe that the FRC’s programme is already full for 2008/09 and therefore have no further suggestions for additional projects in the short term. Additional projects would create additional resource issues for the FRC as well as creating additional burdens for stakeholders replying to the associated consultations. In line with the FRC's principle of proportionate regulation, the CCAB urges greater focus on fewer areas, guarding against regulatory change where there is no proven need and where there could be major unintended consequences.

9. Do you agree with our assessment that there are significant concerns even in the upside scenario about the achievement of the outcome defined in the Strategic Framework in relation to an efficient market for audit services in the UK?

We agree that the market-based measures proposed by the Market Participants Group to address audit market concentration, though more likely to be effective in the long term than regulatory measures, are unlikely to have an immediate effect. However, the expression of a significant concern in the Draft Plan & Budget seems to presuppose that the current level of audit market concentration means that the audit market is inefficient. We do not believe that reports by the Office of Fair Trading in 2001 or Oxera more recently have indicated this to be the case. However, we do agree that there is a risk of audit market instability if the level of audit market concentration were to increase as a result of liability or other issues. This risk will remain while there is a high degree of concentration although the recent change in liability legislation should assist.

Specifically, page 7 of the document does not provide comfort, as significant concerns will remain.

This is another example of how the Plan should be structured so as to focus on the projects and activities, and provide detail concerning the management of the risks identified.

10. Do you have comments on the detailed assessments of the upside scenarios set out in our document Draft Plan 2008/09: Supplementary Information?

We have no comments.

11. Are there any other outcomes in our Strategic Framework where you believe there are significant concerns or serious shortcomings in relation to the upside scenario which we have not identified?

We have no comments.

12. Do you have any comments in relation to our draft Budget proposals for 2008/09?

We have concerns relating to the draft Budget; with a 9% increase in core operating costs for corporate governance, reporting and auditing, together with comments made about increases in future years. It seems that rising staff costs account for most of this. The reasons for recruiting additional staff for POB and AADB activities and for recruiting to vacancies in the APB and the FRRP should be set out clearly in the Draft Plan and Budget for the benefit of stakeholders rather than in the detail of the Supplementary Information

Under Question 1 above we make reference for the need to identify 'business as usual' – the FRC and its Operating Boards will always have to accommodate variable levels of activity (both up and down) because it will need to respond to external events as they happen. The document does not distinguish between 'routine' work and 'reactive' work. The new way of assessing the risks to the delivery of the FRC's strategic outcomes, articulating both downside and upside risks, has its merits in setting out thinking but it appears that there may be the danger of using the downside risks to increase the staff establishment. There is no counter balance from potential upside risks. Overall, the Draft Plan and Budget does not provide us with a high degree of comfort in terms of value for money, control over future costs or extra resources not being used for the FRC's international aspirations.

We note that the FRC announced its levy proposals for 2008/09 on 19 February 2008 and that that document is to be read in conjunction with the Draft Plan and Budget 2008/09. The levy proposals have been made on the basis of a reduction in the level of contribution from the Government in 2008/9 and the assumption that there will be a corresponding increase in the contributions of the accountancy profession and the business community. We are engaged in correspondence with the FRC on this matter so do not intend to respond in detail on the levy proposals. We also note that the FRC intends to consult on the longer term funding arrangements in April 2008.