



### **FRC Draft Plan & Budget and Levy Proposals 2017/18**

ICAEW welcomes the opportunity to comment on the FRC Draft Plan & Budget and Levy Proposals 2017/18 published in December 2016 a copy of which is available from this [link](#). This response was submitted on 16 February 2017 by ICAEW.

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## HEADLINE POINTS

1. As the UK prepares for its exit from the EU, the imperative to have in place efficient regulation and credible regulatory bodies remains strong and indeed grows in importance. ICAEW encourages all UK financial and professional services regulators to continuously improve and to focus on what is most needed to assist UK corporates and professions to thrive and compete in international markets. ICAEW stands ready and is fully committed to working with its partner bodies and the FRC towards assisting in preparation and readiness for the opportunities and challenges which will unfold in the coming years.
2. We fully agree that the key overriding objective for the FRC should be the maintenance of the UK's standing as a global centre of excellence for accountancy, audit and actuarial work all of which should continue to contribute to confidence in the UK as a destination for investment.
3. ICAEW notes the proposal to increase the 2017/18 budget by 4% compared with the previous year with a key cost driver being a 7.5% increase in staff costs reflecting the FRC's increased responsibilities. New responsibilities relating to the Audit Regulation and Directive were cited in the FRC's 2016/17 plan and budget and we commented then that a better explanation of where and how many additional staff will be added would assist transparency. We would repeat that point in relation to the 2017/18 consultation. The introduction of value for money metrics and a sharper focus on KPIs across a number of areas would also assist understanding of proposed budget increases.
4. As the UK faces the competitive challenges of the post-Brexit era, domestic regulators will fall under greater scrutiny in terms of their financial performance. Challenges will arise in striking a sensible balance between efficiency, economy and effectiveness as well as ensuring the costs of regulation as borne by businesses are not excessive. We saw, particularly during the EU Referendum debate, that the cost of complying with EU regulations was a key concern of many businesses.
5. The new administration in the United States has indicated a deregulatory agenda for business and finance (for example, the President has asked for a 'one in and two out' for Federal regulations). Such moves have the potential to make the UK look uncompetitive in comparison. In addition, changes to the Corporate Governance Code could also have relative competitive consequences. These external events have to be monitored and gauged carefully to ensure UK competitiveness.
6. The FRC indicates that it will use the savings it has achieved to accelerate some of the planned build-up in its reserves that would otherwise be made in 2017/18. The proposal this year includes an addition of £0.7m to general reserves (£1.1m in 2016/17). In our response to the consultation on the FRC's 2016/17 budget we queried the rationale for the proposed increase in reserves to six months' expenditure and ICAEW remains of this view. Greater transparency and explanation of the need to hold this level of reserves would be helpful together with a forward view on the need to hold reserves should the FRC be designated as a public body.
7. Strategically the FRC may decide to use savings in another way, perhaps towards reducing the costs of regulation. It is incumbent on all regulators to be conscious that ultimately consumers pay for regulation and to be mindful of this in spending and budgeting plans.

## RESPONSES TO SPECIFIC QUESTIONS

**Q 1: Do you have any comments on our proposed priorities and work programme for 2017/18?**

### The UK's exit from the EU

8. ICAEW welcomes the FRC's proposed priority of '*Playing an active role with other regulators in helping address the challenges and opportunities of Brexit...*'
9. As a Recognised Supervisory and Qualifying Body (RSB/RQB) for statutory audit, ICAEW looks forward to working in partnership with the FRC and others where appropriate, to protect and extend professional recognition within Europe for UK Audit Qualification (AQ) holders as well as maintaining routes for firms to recruit appropriately-qualified professionals from outside the UK.
10. It is clear that the FRC will have to devote more of its existing resources to this recognition area.
11. ICAEW agrees with the FRC's comment on the implications of Brexit for reporting frameworks. Indeed ICAEW is currently in discussions with the FRC over whether students taking UK GAAP papers will be eligible for the AQ in the same way as other students taking IFRS papers.
12. We agree that it will be important for the FRC to be pro-active in assessing the challenges and opportunities that Brexit presents and addressing them appropriately. In some areas within the FRC's remit, stability and equivalence with EU regulations will be the most important consideration for most constituents, even where the EU-derived law is seen as in need of improvement. Often constituents will prefer continuity, even where Brexit opens opportunities for change. The FRC will need to consult with constituents about the preferred course of action in due course. In some areas, such as the application and endorsement of IFRS, decisive actions may be called for.

### The Corporate Governance Code

13. ICAEW welcomes the FRC's focus on updating the Corporate Governance Code (the Code) as its first priority: '*In the light of concerns about trust in business, updating the Corporate Governance Code and associated guidance, and promoting effective investor stewardship*'. Updates to the Code will need to reflect the outcomes of the BEIS consultation on corporate governance reform.
14. We broadly agree with the need for updating the Code for listed companies and look forward to future Finance Lab case studies on the topic. However, we have a number of comments below on proposed FRC actions relating to corporate reporting.

### The costs of regulation for business

15. The FRC correctly states that regulators need to be wary of creating unnecessary costs for business. In this context and in light of upcoming challenges for UK businesses in particular from the UK exit from the EU, it would be pragmatic and forward thinking of the FRC to focus on the organisation itself delivering value for money in its activities, as a priority for 2017/18. More information on staffing levels, key cost drivers and relevant metrics-based KPIs would assist transparency in this respect.

### The effectiveness of regulation: quality control and feedback

16. The 2017/18 draft plan and budget provides little information on the forms of oversight or quality control to which the work of the Audit Quality Review Team (AQRT) will be subject. Given that one of the drivers of staff cost increase in 2017/18 is '*the flow through of the additional resources necessary to fulfil our obligations following our appointment as the Competent Authority in the UK for audit*' the demonstration of quality control and efficiency in

this area should be high on the FRC's agenda.

17. As the FRC grows in size and expenditure it will be appropriate to devise new ways to demonstrate value for money to constituents in the areas of audit quality and public interest disciplinary cases as well as designing ways to seek feedback from those under its wider regulatory remit.

### Corporate reporting

18. In terms of the FRC's fourth priority: *Promoting clear and concise corporate reporting*, ICAEW agrees that this is an appropriate priority for the coming year. We make some further comments on the FRC's corporate reporting activities under question 4 below.

### Audit: more challenges ahead

19. There are likely to be many challenges for auditors in the forthcoming period, including matters of interpretation and practical application in applying the new FRC standards. Guidance regarding some of these matters is likely to be needed and ICAEW would be pleased to discuss with the FRC how best this guidance can be provided and ICAEW's role in this. We also support the timely revision of the FRC's audit practice notes and bulletins, and are also willing to discuss ICAEW's involvement where it is agreed that revision is needed.

### Q2: Do you have any comments on our proposed effectiveness indicators?

20. ICAEW notes and welcomes on page 3 of the consultation document the goal of '*Ensuring FRC is effective and efficient*'. However, many of the proposed indicators in the document are qualitative rather than more rigorous metrics-based KPIs. For example, on page 11, only one of six indicators relating to the FRC's role as the Competent Authority is quantitative in nature.
21. In our response to last year's consultation we suggested 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 issue of formal charges. The FRC may wish to give consideration to a form of KPIs similar to these in relation to AQRT review visits, where the proposed indicator relates narrowly to the 'findings...from audit quality review activities'.

### FRC staff resourcing

22. The FRC's staffing costs are set to increase by £1.5m in the 2017/18 budget, an increase of 7.5% on the previous year. In addition to staff increases relating to the FRC's Competent Authority status and development of the UK's corporate governance framework, we note an increase in staff in the enforcement area. The team has expanded since 2013 with plans to expand further in 2017. It would be helpful to understand in which areas or aspects of enforcement these resources will be deployed. The inclusion of statistics on number of cases concluded in a year and length of time to conclude cases would assist as effectiveness and efficiency metrics.

### Q3: Are there any areas where the FRC could reduce its proposed activities without reducing the overall impact of FRC regulation?

23. We welcome the FRC's upcoming review of the speed of its case reviews and prosecutions approach and the effectiveness of the sanctions imposed.

### Q4: Are there any significant risks to the quality of corporate governance and reporting in the UK which are not addressed in the proposed work programme?

## Promoting High Quality Corporate Reporting

24. We broadly agree with the proposed projects and activities. In particular we would stress the importance of taking all necessary steps to maintain the influence of the UK over the development of IFRS. We also strongly support the Digital Future project and the suggested thematic reviews.

## UK GAAP

25. We suggest that the reference to evaluating the impact of the new UK GAAP be extended and accorded more prominence; the FRC should continue to carefully assess the need for clarification and guidance as smaller companies begin to apply FRS 102 for the first time. At the same time, the FRC should recognise the importance of stability and continuity in financial reporting requirements for UK GAAP reporters following the extensive changes of recent years. We have emphasised this in our recent comments on the triennial review.

### Q5: Do you have any comments on our proposed levy rates?

26. We note that the total contribution of the accountancy and audit profession to the FRC's expenditure in 2017/18 is £17m, approximately 50% of the total. The remainder is made up mainly from the preparers levy. There is no contribution from UK government despite the centrality of the FRC's work to the health of UK corporate and professional services.
27. The preparers levy is shared over a large population of listed and similar entities. It is the case that a high proportion of costs placed with the profession is shared among a far smaller base in terms of audit firms within scope. Nearly £7m is sought to fund AQRT activity in 2017/18 which is borne by a very small number of firms. ICAEW recognises that confidence in audit is a key component in investor confidence and that firms auditing public interest entities (PIE) need to be reviewed. In this context we have commented above on the need for performance measures for AQRT above and beyond 'findings' from review work.
28. The total cost of AQRT regulation is rising significantly. In this context it may become prohibitively expensive for some audit firms to remain in the PIE market. This would run counter to the recommendation of the Competition and Markets Authority which encouraged the FRC to stimulate growth and choice in the audit market. However ICAEW recognises that the reality of the situation, particularly with liability considerations, is that a reduction in the number of firms willing to serve the PIE market is virtually inevitable.

## Reserves

29. In our response to the consultation on the 2016/17 budget we queried the rationale for the proposed increase in FRC reserves to six months' expenditure and we remain of this view. As we stated last year the professional accountancy bodies are financially secure with good covenants. If these reserves are held to be required in the event of a winding-up of FRC then there will be a range of options to meet any obligations (including good time for the government to invoke a statutory levy).
30. It is noted that the FRC will add £0.7m to its reserves during the year (£1.1m 2016/17). It would assist transparency if the consultation document explained in more detail the extent to which the FRC's reserves policy is in line with best practice or comparable organisations and under what circumstances the FRC would consider refunding operational savings to the funding bodies.
31. ICAEW is aware that the FRC's status may be changed to that of a public body in the near future. Depending on the precise status or type of public body designation, we would be interested to understand the implications for the future levels of reserves required by the FRC given the possibility that the government, if not willing to directly fund the FRC, may be in a position to underwrite it as a going concern.