Title: Proposals to Reform the Financial Reporting Council **IA No:** BIS0331 **Lead department or agency:** Department for Business, Innovation and Skills **Other departments or agencies:** Financial Reporting Council	# Impact Assessment (IA) **Date: 02/02/2012** **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries**: Angela Rabess 020 7215 1661

Summary: Intervention and Options

RPC Opinion: AMBER

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£8.2m	£3.3m	£0.375m	Yes	OUT

What is the problem under consideration? Why is government intervention necessary?

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. The FRC has reviewed its role after the financial crisis. The Government agrees with the FRC on its general effectiveness. There are however 4 constraints on its effectiveness: its scope is not aligned clearly enough with its mission; its structure is over-complex, with some FRC powers given to subsidiary bodies rather than the FRC Board; and in its role as an audit regulator, the FRC is not sufficiently independent from those it regulates; nor is it equipped with a proportionate range of sanctions. Government intervention by changing secondary legislation is necessary to enable the FRC to address some of these constraints effectively.

What are the policy objectives and the intended effects?

The overall objective is to fine tune the current arrangements by dealing with the four contsraints so as to create a more effective, efficient and independent FRC and minimise the regulatory burdens on market participants. The supporting objectives are to: Enhance the effectiveness of the FRC's contribution to the efficient operation of the capital markets by focusing its monitoring and enforcement activities on publicly traded and large private companies; Enhance the FRC Board's ability to focus on key corporate governance and reporting issues; Contribute to the quality of auditing in the UK through enhanced independence from the accountancy professional bodies and a more proportionate range of sanctions.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Three approaches have been considered and refined following consultation. These are:
Option 1 - A set of finalised proposals to deal with the 4 constraints so as to streamline and enhance the FRC's present regulatory approach, supported by changes to secondary legislation. This is designed to achieve the desired objectives while reducing the costs associated with FRC regulation.
Option 2 - Do nothing. This would leave in place the 4 constraints and forgo the opportunity to reduce the costs associated with FRC regulation.
Option 3 - New arrangements operated by the FRC to licence audits of entities in which there is a major public interest, supported by primary legislation. This would mirror arrangements operated in the US and a number of other jurisdictions and reinforce the FRC's independence; but would impose additional costs on market participants.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 04/2015

Does implementation go beyond minimum EU requirements?			Yes / No / N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** No	**Large** No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: .... Date: 26/03/12

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -	**High:** -	**Best Estimate:** 8.2

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	-		-	**-**
High	-		-	**-**
Best Estimate	0.48		0	**0.48**

Description and scale of key monetised costs by 'main affected groups'

The costs associated with implementing the reform proposals would be met from the resources provided by FRC's existing funding groups - the groups subject to the FRC's voluntary levy on preparers of accounts and the accountancy professional bodies. The FRC has explained in its published Plan for 2011/12 that the costs will be met through a reduction in reserves and there will not, therefore, a resulting increase in the amounts requested from the FRC's funding groups for 2011/12 or 2012/13

Other key non-monetised costs by 'main affected groups'

Familiarisation costs to business are not expected to be significant. The FRC's ability to require sanctions to be imposed on audit firms for poor quality audit (rather than request their imposition by the professional bodies), and the more proportionate range of sanctions against professional bodies that fall short in their responsibilities, will only affect accountancy bodies and audit firms and would in most cases be equivalent to those that would be applied under the current arrangements.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	-		-	**-**
High	-		-	**-**
Best Estimate	0		1.04	**8.2**

Description and scale of key monetised benefits by 'main affected groups'

The main beneficiaries are businesses (from 2012/13 - Y0), particularly firms and individuals in the audit market (see Annex B).The most significant benefits identified are in relation to the early settlement of disciplinary cases (£750k a year), streamlined FRC governance (£260k a year) and the proposal to faciliate changes to the disciplinary scheme for accountants (£32k a year). Narrowing the scope of the FRC's work (previously £280k per year) following consultation is now cost neutral.

Other key non-monetised benefits by 'main affected groups'

The proposals will strengthen the role of the FRC in the regulatory framework for corporate governance and reporting. This benefits the UK economy through increased confidence in the value of information available to capital market participants in making investment decisions. Although they are difficult to quantify, not least because they are tweaks, the non-monetised benefits are expected to be significantly greater than the monetised benefits because of the size of UK capital markets.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

These proposals are designed to be effected by secondary legislation and to come into force in 2012/13. The FRC has used past experience to develop its estimates of the overall savings associated with proposals. The main risks to the proposals would arise if the estimated savings in relation to the disciplinary arrangements were not achieved.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits:** 0.375	**Net:** 0.375	Yes	OUT

Evidence Base (for summary sheets)

Proposals to reform the FRC – Supporting Analysis

1. Introduction

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. Good governance improves boards' ability to enhance performance effectively as well as providing accountability to shareholders. Good reporting meets the needs of investors for relevant and clearly-communicated information on governance, business models and company performance.

In support of its mission, the FRC:

- promotes high standards of corporate governance through the Corporate Governance Code and Stewardship Code;

- contributes to high-quality corporate reporting by setting standards for accounting, auditing and actuarial practice, influencing international standards, and monitoring the implementation of accounting and auditing standards in the UK; and

- oversees the regulatory activities of the professional accountancy and actuarial bodies and operates independent disciplinary arrangements for public interest cases involving accountants and actuaries.

In the aftermath of the financial crisis, the FRC reviewed its role with Government and with its stakeholders and identified constraints on its effectiveness. The Government agrees with the FRC and stakeholders on the general effectiveness of the current arrangements. However four constraints have been identified. How to deal with these constraints was the subject of a BIS/FRC public consultation "Proposals to Reform the Financial Reporting Council" together with a consultation stage impact assessment.

This updated impact assessment sets out the finalised proposals following consultation with stakeholders. The consultation period ran from 18 October 2011 to 10 January 2012. As part of the formal consultation, 75 responses were received, including respondents from investors, audit and accountancy firms, accountancy professional bodies and individuals. In addition, the BIS and FRC engaged with those stakeholders most directly affected by the proposals during the consultation to address, among other issues, the potential costs/benefits to business of the proposals. This included a series of workshops with investors, businesses and business groups and the accountancy and actuarial profession - as well as individual meetings with members of these groups. There has been continued subsequent engagement.

Following these extensive formal and informal consultation processes, this assessment maintains the two key points set out in the consultation stage impact assessment:

- The biggest prize in terms of the reform proposals is that the FRC will be more effective as part of the UK's overall regulatory framework which promotes corporate accountability and transparency, encourages responsible business behaviour and so provides the markets with confidence. An FRC that is over-complex in its structure or that risks the perception that it is not sufficiently independent from the professions it regulates will be less effective in that role.
- Those more specific aspects of the proposals that can, to a reasonable degree, be quantified will reduce the costs associated with FRC regulation.

In the light of further discussion with stakeholders, the estimates of quantifiable costs and benefits have been refined so that the overall savings are £280k less per year than in the consultation stage impact assessment (see detailed assessment of proposal 1). The reduction in estimated direct savings to business is approximately £140k per year. This has been reflected in the monetary values in the summary sheets.

The main issues identified by stakeholders were the value of greater detail, particularly the detail of proposals on sanctions, and a fuller assessment of the risks identified.

BIS, FRC and its stakeholders recognise that FRC's role in fostering investment in capital markets is potentially of much greater significance than the annual savings quantified here, and that this wider significance is not as straightforward to quantify. It is however essentially a constant backdrop across all the proposals of changes considered in this AI, which is concerned only with the four constraints. Work has however been set in hand with stakeholders to evaluate the wider impact of the FRC.

Impact on business

As a result of the consultation BIS believes it is reasonable to assume that the estimated annual net cost benefit figure in terms of the direct impact on business as part of the One-In-One-Out calculation is -£0.375m. This does not include the savings of proposal 5 which does not require legislation. Including proposal 5, the direct impact is £391,000. A summary of the EANCB by proposal is at Annex B.

As a key representative of stakeholders, the Consultative Committee of Accountancy Bodies (CCAB) responded to the consultation by noting that the IA could be clearer on the distribution of the savings achieved by the proposals. In addition to the direct monetised savings to business, particularly in proposal 6, the FRC funding arrangement mean that any savings it makes as a result of the proposals will reduce costs to the regulated community from which it maintains its funding.

Since the publication of the consultation stage impact assessment in September, the FRC has further developed its approach to regulation by establishing the Financial Reporting Lab. The Financial Reporting Lab offers an environment where corporates and investors can come together to develop pragmatic solutions to today's reporting needs. This is a consensus-building approach which seeks to find innovative solutions to the needs of businesses and investors and has does not seek to create a regulatory burden as the outcomes of the lab are market led.

Further detail of the comments received and the FRC's response is available in the remainder of this final stage impact assessment which will be published on the BIS website (www.bis.gov.uk/consultations.)

2. <u>The case for change</u>

The FRC – An evolving organisation

The context in which the Financial Reporting Council (FRC) currently operates is summarised at Annex C. The current and proposed structure of decision-making groups within the FRC[1] are summarised at Annex D. The FRC's powers are summarised in Annex E.

The FRC has evolved considerably in terms of its role and structure since it was established in 1990. It was originally formed to promote good financial reporting through two subsidiary bodies:

- Accounting Standards Board (ASB) – Sets UK accounting standards and now devotes a large part of its activities to influencing the setting of standards by the International Accounting Standards Board (IASB) and their adoption in the European Union (EU).

- Financial Reporting Review Panel (FRRP) – Reviews the reports of publicly traded and private companies for compliance with financial reporting requirements and, where appropriate, seeks corrective action from directors.

Following the collapses of Enron and WorldCom in the US the Government announced in January 2003 a package of reforms to raise standards of corporate governance, strengthen the accountancy and audit professions, and provide for an independent system of regulation for those professions in the UK. The FRC was given a central role in delivering these reforms.

The FRC's original remit was enlarged to give it:

- a more active role in relation to corporate governance,

- a proactive role in relation to compliance with accounting standards, and

- new responsibilities in relation to audit, auditing standards and the oversight of the regulatory activities of the professional accountancy bodies.

To fulfil this remit, the FRC acquired three new subsidiary bodies:

- Auditing Practices Board (APB) - Issues standards and guidance for auditing, for the work of reporting accountants in connection with investor circulars and for auditors' integrity, objectivity and independence. The APB is also active in influencing the setting of international standards on auditing by the IAASB.

- Professional Oversight Board (POB) - Provides statutory oversight of the regulation of the auditing profession and independent oversight of the regulation of accountants by their respective professional bodies. The Audit Inspection Unit (AIU), which is part of the POB, monitors the quality of the audits of economically significant entities.

- Accountancy Investigation and Discipline Board (AIDB) – The UK's independent investigative and disciplinary body for accountants.

[1] See Annex C for comparison of current and proposed decision-making groups.

As part of its expanded remit, the Secretary of State gave the FRC family responsibility for independent oversight of statutory audit as described in company law[2] and the EU Directive[3].

Following the collapse of Equitable Life and the Morris Review of the Actuarial Profession the Government asked the FRC to take on new responsibilities for setting technical actuarial standards and oversight of the actuarial profession. A new subsidiary body was established:

- Board for Actuarial Standards (BAS) - The UK's independent setter of technical actuarial standards.

The POB took on responsibility for the oversight of the actuarial profession; and the AIDB took on responsibility for actuaries and became the Accountancy and Actuarial Discipline Board (AADB).

The FRC was originally funded on the basis of a preparers levy on listed companies and contributions from other bodies with an interest in standards of reporting in the UK. Following the changes implemented in 2004 the FRC was funded on the basis of contributions from the preparers levy, the accountancy professional bodies and the Government. The three groups each contributed a third share of the costs of the FRC's core operating activities. The accountancy professional bodies funded the costs of audit inspection carried out by the AIU and disciplinary cases taken forward by the AADB.

New and separate arrangements were implemented in 2006 to fund the FRC's responsibilities for actuarial standards and regulation based on contributions from insurance companies, pension schemes and the actuarial profession.

In 2008, the FRC undertook two major consultation exercises. The first invited views from its stakeholders on the cost-effectiveness of FRC regulation and ways in which this could be enhanced without compromising the effectiveness of the UK's regulatory framework for corporate governance and reporting. This suggested broad support for the FRC's approach, and emphasised the importance of continuing close engagement with stakeholders on new initiatives.

The second consultation sought views on the arrangements for funding the FRC's regulatory activities following the Government announcement in February 2008 that it intended to phase-out its annual grant. As a result of that consultation, the FRC reaffirmed its intention to continue to collect the funds it required on a non-statutory basis, but extended the scope of its preparers levy to include large private companies and public sector organisations. The arrangements for funding audit inspection and disciplinary cases involving accountants, and the actuarial funding arrangements, remained unchanged.

The FRC's budget for 2011/12 is £22.5m, which is met through the voluntary funding arrangements agreed with stakeholders. This is in the process of being raised as follows:

- £6.4m from business through the preparers levy (£4.4m from publicly traded companies; £1.6m from large private companies; £0.4m by public sector organisations),
- £11.9m from the accountancy professional bodies,
- £0.5m from Government,

[2] See Schedule ten 24 (1) (a): http://www.legislation.gov.ukukpga/2006/46/contents

[3] EU Directive on Statutory audit can be found here: http://ec.europa.eu/internal_market/auditing/directives/index_en.htm

- £2.9m under the actuarial funding arrangements, and
- £0.8m through a reduction in reserves.

The budget for 2012/13 will be set following consultation in 2012. The FRC consults annually on its budget and funding arrangements.

Problem under consideration – the need for further change

As it has evolved, the FRC has demonstrated a strong track record and developed deep relationships with its stakeholders, which in combination have led it to be highly regarded. The consultation on the reform proposals has broadly confirmed this perception. But there are underlying reasons why the FRC needs to continue to evolve.

The external environment has grown ever more challenging. At a time when business and the provision of finance is becoming increasingly complex and globalised, investors and capital markets need reliable in-depth information about the business of a company, its strategy, the risks to its success and the ways in which it manages those risks. The Government and the FRC regard it as important that the FRC should have the regulatory focus, structure and powers that will enable it most effectively to respond to that need.

There have been a number of policy developments with implications for the FRC. These include:

- In February 2010, the Government published the FRC's Hampton Review Report (www.bis.gov.uk/bre). The Report concluded that the FRC complied with the principles of good regulation, but invited the FRC to consider the need for greater consistency between its operating bodies and the need to avoid consultation overload.

- In October 2010, as part of its Public Bodies Review Programme, the Government announced that the FRC would be retained but substantially reformed, and its reliance on public funding removed.

- In March 2011, the House of Lords Economic Affairs Committee concluded, as part of its investigation into Auditors: market concentration and their role, that: "The regulation of accounting and auditing is fragmented and unwieldy with manifold overlapping organisations and functions. This is neither productive nor necessary."

- Government policy and the regulatory architecture are changing to meet the challenges of regulating the financial markets. The Bank of England is assuming new powers and the Kay review has been commissioned by BIS to investigate the role of equity markets in shaping UK businesses. These initiatives are underpinned by the Government's 'Plan for Growth', which stated the need for action toward improving corporate governance. The FRC's role in ensuring that relevant and accurate information is shared effectively will be integral to both the operations of financial markets specifically and equity markets in general.

Taking these developments as the starting point, the FRC announced in its Plan & Budget 2011/12, published in April 2011, that working with Government it would further develop to ensure that it has the right powers and structure to deliver with full effectiveness its mission of promoting high quality corporate governance and reporting – so contributing to the efficiency of the capital markets in the UK.

The FRC worked with Government and stakeholders to identify four principal constraints on its effectiveness which need to be addressed if it is to achieve this objective.

Two of these constraints apply to the FRC as a whole:

- It has a range of regulatory activities which extend beyond its core mission of supporting the effective functioning of the UK capital markets – including, for example, monitoring audit quality for entities that are not publicly traded such as charities that would otherwise be covered by the monitoring arrangements operated by the professional bodies.

- It is structured in a way that is over-complex and insufficiently understood. Each of its seven operating bodies has a discrete function within the FRC's overall function. Statutory powers or recognition is currently focussed on each operating body, rather than the FRC as a whole. As a result there is a risk that in aggregate regulation by the seven different bodies will either be over-burdensome or miss issues, as the FRC Board does not have the necessary remit or power to link together formally different workstreams.

Two of the constraints relate to its role as an audit regulator:

- It is not sufficiently independent from the accountancy professional bodies in its supervisory, monitoring and disciplinary role in relation to audit. For example, the AADB has to refer cases of poor quality audit to a committee of the relevant professional body and seek its agreement before the AADB can take action. As a result, there is a risk of regulatory capture.

- It is not equipped with a proportionate range of sanctions. Currently the POB has two options: to remove recognition of a professional body that fails to meet the required standards or to require a professional body, through application to the courts, to take action. The standing and conduct of the professional bodies makes such a heavy handed response inappropriate.

A majority of stakeholders recognised the case for reform. In terms of the key responses, many respondents confirmed the importance of proportionate powers and independence whilst also recognising that a clearer structure and scope would be of benefit.

Those that opposed the case for reform were largely concerned to establish that the reform programme would be accompanied by transparent and fair procedures. The FRC has now extensively consulted on the detail of the proposals with stakeholders that had concerns. As a result of this extensive consultation, the FRC is now confident that the majority of stakeholders on whom it relies to be effective are in support of the proposals.

3. Options considered

The limited range of options open to the FRC

In carrying out its statutory duties, the FRC needs an appropriate range of regulatory interventions at its disposal. BIS and FRC do not propose to effect reforms which may have unjustifiably high costs to business. The FRC is also constrained by EU requirements on oversight of statutory audit. This acts as a lower limit to how far it may deregulate. Working within this narrow range of regulatory options for reform, the FRC has considered what it believes is a proportionate response to the problems: (Option 1). It has also considered an alternative (Option 3).

Policy objective

The overall objective is to resolve four specific constraints so as to create a more effective, efficient and independent FRC that contributes to the efficiency of the capital markets and minimises the regulatory burdens on market participants.

Three broad policy options were identified and have been reviewed following the consultation process. :

Option 1 – Streamlining the FRC's governance and structure and reforming its powers to provide greater independence and more proportionate sanctions (preferred option):

This option has four main aspects, which are set out in detail in section 4:

- **Aligning the FRC's scope with the investment focus of its mission** – the FRC's remit is not at present sufficiently clearly defined and limited by its mission. A tighter focus will enable the FRC to focus its activities on the areas of greatest economic importance, while retaining work to maintain an appropriate framework of UK accounting and auditing standards which are of value to smaller companies and other entities.

- **Enable the FRC Board to focus its activities on major challenges** – issues faced by firms and individuals affected directly by corporate governance and reporting are increasingly thematic in nature e.g. in disclosing risk or assessing the value of audit. Such challenges do not sit with any one of the FRC's current seven subsidiary (operating) bodies, and hence are difficult to address within its current structure. This means that key pieces of work have to be managed in an ad hoc fashion. The current structure is potentially inefficient and crucially may mean that links between areas of work are made too late, if at all. A streamlined structure will mean the FRC is more able to respond to risks to the quality of corporate governance and reporting and thereby reduce the adverse impact of information asymmetry between market participants.

  Delegating the Government's powers in future mainly to the FRC Board rather than the FRC's subsidiary bodies (as at present) will enable the FRC Board to provide clearer strategic oversight and joining up so that the FRC as a whole can focus on achieving regulatory outcomes which command broad support from investors, the corporate sector and the professions. The FRC will be in a stronger position to consider the overall impact of regulation on the markets, exploring alternatives to regulation where appropriate; and a stronger position to influence the development of EU and international policies which impact on UK market participants.

- **Reinforced independence from the accountancy professional bodies** – the FRC operates as an independent audit regulator and so must avoid any perceptions of regulatory capture, while maintaining effective relationships with its stakeholders. The FRC should in future be in a position, through the statutory framework and the terms of its arrangements with the professional bodies, to require rather than, as at present, recommend the professional bodies to apply appropriate sanctions for poor quality audit. The importance of independent oversight of audit is supported by the markets[4]. Similarly, the FRC should be able to amend the disciplinary scheme in close consultation but without having to seek agreement of professional bodies.

[4] See link for evidence: http://www.pwc.com/gx/en/press-room/2011/major-global-accing-nets-support-announcement-of-coop-agreement.jhtml

Updating the secondary legislation which gives the FRC its powers to promote high quality audit will reinforce its independence from the audit profession and enable it to tackle issues which require intervention more effectively than at present without imposing new regulatory processes.

- **A more proportionate range of sanctions and procedures** – proportionate sanctions and procedures are a necessary tool for effective regulation. The FRC currently only has two statutory ‘nuclear options’ with regard to the professional bodies that it regulates: it can either take away the licence of professional bodies or require them, through the courts, to take action. The availability of a more proportionate range of sanctions, through the statutory framework and the terms of its arrangements with the professional bodies, would enable the FRC to influence the professional bodies more quickly.

- Similarly, a process for the early resolution of disciplinary cases without recourse to a full disciplinary tribunal where all the parties agree would enhance the effectiveness of the current disciplinary arrangements without compromising their procedural fairness.

Immediately quantifiable costs and benefits

The finalised proposals are designed to reduce the overall costs to market participants and the FRC. The estimated savings total approximately £8.2 million over 10 years.

Wider/longer-term costs and benefits

The FRC has a significant role in the regulatory framework of the UK. The proposals in this package will enable it to play a more effective role in the regulatory framework and thereby contribute more effectively to the quality of corporate governance and reporting in the UK.

The monetisation of the FRC’s work as a whole is difficult as the quantification of the effect of confidence in markets is difficult to both identify and also isolate from other effects on market prices and/or the quantum of investment. It would be even more difficult to seek to quantify a monetised value for the changes in the FRC’s work with which this IA is concerned.

Option 2 – Do nothing: the FRC is well regarded in the UK, the EU and internationally. It would be open to the Government and the FRC to continue with the present arrangements.

However, this option would be inherently unsatisfactory for the reasons set out above. It would leave unchecked the possibility of sub-optimal regulation of corporate governance and reporting, ignore the concerns expressed by others about the complexity of the present arrangements; and forgo the opportunity to achieve efficiency savings.

Option 3 – Additional licensing arrangements for the audit of entities in which there is a significant public interest: An alternative option which was mooted in public earlier last year would be to establish a registration scheme for the audit of entities in which there is a public interest. This would build on the proposals to align the focus of the FRC’s activities with the investment focus of its mission and to streamline its structure. It would replace the proposals on independence and sanctioning set out as part of Option 1.

The licensing arrangement could be based on a requirement to file relevant annual and other reports with the FRC as a basis for registration, but with no presumption on registration that a registered auditor met any specified criteria for the quality of its work other than existing registration with its RSB. Registration would come with the condition that the firm would comply with certain obligations imposed by the FRC. The quality of a registered firm’s work would be tested through a monitoring process; and shortcomings identified through that process could leave a registered firm open to a range of sanctions.

Comparable arrangements are in place in other jurisdictions (for example the current US scheme).

This option would involve significant additional costs for both the FRC and market participants. A scheme on these lines would be additional to the current arrangements operated by the accountancy professional bodies.

Following consultation, the FRC has provided more detail on what a licensing arrangement for the UK would look like and how this compares with the preferred option. None of the consultation respondents favoured this option.

Alternative options considered:

On the basis of the responses to the consultation on its reform proposals (the Preferred Option 1 set out in the consultation stage impact assessment) the Government and the FRC considered carefully whether there were alternatives to the proposals that might achieve the same objectives more effectively and efficiently within the parameters set by current EU legislative requirements.

Some respondents to the consultation suggested varying the set of proposals in Option 1 to create alternatives For example, removing the proposal to narrow the scope of the disciplinary arrangements (proposal 1) or the proposal to make its primary focus listed and large private companies (proposal 2), or both. However, on careful consideration, BIS and the FRC conclude that changing the detailed composition of proposals would compromise the effectiveness of the overall package with little or no impact on cost savings.

Option 1 – Streamlined structure/Reformed powers (preferred option)

Summary

This section summarises the final proposals for reform of the FRC and notes the monetised impacts.

The consultation stage preferred option (Option 1) was made up of seven proposals four of which would require changes to secondary legislation

Two of these proposals, which do not require legislative change (Proposals 1 and 2), will be kept under review but will not be implemented at this stage and will be subject to further discussion with stakeholders.

This finalised impact assessment includes the assessment of all seven proposals but does not count the impact of Proposals 1 and 2 as part of the formal cost benefit analysis. BIS and the FRC believe that this will provide clarity to stakeholders on the feedback from the consultation on all the proposals and transparency around the decisions that have been made.

An investment focus for the FRC's regulatory activities

Consultation Proposals 1 and 2 were designed to clarify the investment focus of the FRC through changes to its scope on codes & standards and disciplinary work.

- Proposal 1: the FRC should set or promulgate standards for governance, accounting, audit and actuarial work in the interests of investors in the corporate sector with its primary focus, including in relation to enforcement, being on publicly-traded and the largest private companies;

In response to the consultation, the FRC does not propose to change the scope of its work in setting codes and standards. **(Detailed Assessment of proposal 1 – Page 17)**

- Proposal 2: the scope of the FRC's accountancy disciplinary arrangements should be narrowed to cover the quality of work and conduct of accountants in relation to the audit of statutory accounts and assurance reports for the capital markets. It should leave all other cases of potential misconduct to be dealt with by the relevant professional body.

In response to the consultation, the FRC does not propose to change the scope of its activities at this time but will continue to consult those with an interest in its work to ensure that the scope of its activities, including in relation to conduct, remains appropriate and effective. **(Detailed Assessment of proposal 2 – Page 18)**

Streamlined governance and structure

The FRC should be more streamlined and efficient, while remaining well connected to and informed by market participants. Proposal 3 will meet this objective.

- Proposal 3: statutory powers should be delegated direct to the FRC Board or, if appropriate, to one of its Committees, and not to its individual operating bodies as at present, so as to enable the FRC to operate efficiently and strategically without a loss of market participants' input and within a streamlined structure;

Taken together, these finalised proposals would provide modest (£260k a year) savings from the reduction in the complexity of the FRC's current decision-making arrangements. They would enhance the FRC Board's ability to manage the overall costs of FRC regulation and more strongly influence EU and international developments that might impact on regulatory costs incurred as a result of EU or global initiatives in relation to corporate governance and reporting. **(Detailed Assessment of proposal 3 – Page 19)**

Reinforced independence

Proposals 4 and 5 are designed so that the FRC's supervisory and disciplinary responsibilities are established as more firmly independent of the regulated community.

- Proposal 4: the power to require a recognised supervisory body to impose proportionate sanctions on an audit firm and/or individual auditor in respect of poor quality work;

This would clarify and strengthen the present arrangements but should not increase the overall costs of regulation. **(Detailed Assessment of proposal 4 – Page 23)**

- Proposal 5: the ability to make its own rules for the independent disciplinary arrangements which it operates in relation to accountants without being required to obtain the agreement of the accountancy professional bodies.

This will provide a modest benefit (£32k a year) by simplifying the arrangements for securing improvements to the disciplinary arrangements. **(Detailed Assessment of proposal 5 – Page 25)**

Proportionate sanctions and procedures

Proposals 6 and 7 will ensure the FRC has a range of proportionate sanctions and procedures.

- Proposal 6: the FRC should have the ability to use its enforcement powers in a more proportionate manner against the recognised supervisory and qualifying bodies if they fall short of their responsibilities;

Given the constructive relationship between the FRC and the professional bodies this will enhance the FRC's perceived independence in its role in overseeing their activities - but should not increase the costs associated with FRC regulation. **(Detailed Assessment of proposal 6 – Page 27)**

- Proposal 7: the FRC should be able to take disciplinary action against individuals or firms without the need for a full tribunal hearing provided that this would not be contrary to the public interest and the parties agree;

This is expected to enhance the efficiency of the present disciplinary arrangements without reducing effectiveness or fairness, and should reduce the costs of the arrangements (by an estimated £750k a year). **(Detailed Assessment of proposal 7 – Page 29)**

In addition to, proposals 6 and 7, supervisory inquiries will help provide an understanding of the reasons for the collapse or near collapse of a public interest entity or other issue affecting confidence in corporate governance and reporting.

- the FRC should undertake supervisory inquiries at its own initiative into significant matters of concern.

These inquiries will support FRC regulation from within the FRC's overall resources and it's proposed to conduct them on the basis of the FRC's reformed powers. They are not, therefore, subject to a detailed assessment. If in the light of operating the new arrangements the Government considers that the FRC requires additional powers to secure information, which might carry implications for the costs of FRC regulation, it will consult further and will develop the necessary impact assessment.

Monetised costs and benefits

Table 1 below summarises the net monetised costs and benefits of each of the finalised proposals following consultation. Costs and benefits of proposals by impact of business can be found in Appendix A.

The beneficiaries will primarily be the businesses which contribute to the costs of FRC regulation through the preparers levy and the accountancy professional bodies (and their members) which fund the FRC's audit inspection and disciplinary arrangements.

Table 1 – Summary: the monetised net value of final proposals under Option 1 (Preferred Option):

Summary: monetised costs and benefits of Preferred Option (£)		Net Value		
		Transitional	On going	
Proposal		Current Price £k	Current Price £k	Present Value £k
An investment focus for the FRC's regulatory activities				
1	Narrowing the scope of audit inspection (NOT IMPLEMENTED AT THIS STAGE)	-	-	-
2	Narrowing the scope of disciplinary arrangements (NOT IMPLEMENTED AT THIS STAGE)	-	-	-
Streamlined governance and structure				
3	Powers with the FRC Board; not the Operating Bodies	**-480**	**240**	**1,600**
Independent supervisory and disciplinary arrangements				
4	Powers to require professional bodies to impose sanctions for poor quality audit	0	**0**	**0**
5	Powers to make rules which it can operate without being required to obtain the agreement of the professional bodies.	0	**32**	**280**
Proportionate sanctions				
6	Powers to conclude disciplinary cases without Public Hearing	0	**750**	**6,500**
7	Powers to sanction professional bodies	0	**0**	**0**
	Total	**-480**	**1,030**	**8,380**

Key: Rows shaded in grey require legislative changes.

Non-monetised costs and benefits

Observations of the impact analysis from consultation included a view from some respondents that there was insufficient analysis of non-monetised costs. Respondents' recommendations included for the need for the FRC to develop a means of analysing these costs to include measurements and forecasts of improved independence, speed of handling and other cited benefits of the proposals. Respondents cited examples of perception/opinion scoring by stakeholders as a way of achieving this.

The FRC, in its post implementation review, will consider data on perceptions of independence and the non-monetised costs and benefits of its reform proposals through its annual stakeholder survey.

In recognition of the weight of the non-monetised benefits, the FRC will use survey evidence including its annual stakeholder survey to test whether or not these benefits are realised. The FRC will report on these as part of the post-implementation review of the reform proposals.

Detailed Assessments - assumptions

The Detailed Assessments are based on the following assumptions:

- The costs and savings for market participants in relation to the operation of the FRC's monitoring and enforcement functions are assumed to be broadly equivalent to the costs incurred by the FRC. The FRC believes that this is a reasonable working assumption given that costs associated with the finalised proposals are largely legal and administrative costs which are likely to be at comparable levels for both the FRC and market participants.

- The time period chosen is 10 years. This is the standard period recommended by BIS guidance and is appropriate for these finalised proposals as they are unlikely to require change within this period of time. A longer period is not suitable as this would be cover more than one "business cycle".

- The present values are based on 3.5% discount rate. This is the standard discount rate and is a fair reflection of the present value of future costs and benefits.

- Proposals effected by secondary legislation are assumed to come into force in 2012/13.

- Where possible, best estimates are provided and are based on a range. For example, proposal 2 has a range which is used to provide a best estimate.

- The operation of the current regime is a reasonable guide to the impact of the new arrangements in terms of costs and benefits.

In the detailed assessments for each proposal, the impact on the costs and benefits associated with FRC regulation are highlighted in bold. The assumptions reflected in the highlighted sections are analysed in more detail on page 18.

<u>Detailed Assessment 1 – An investment focus for the FRC's activities – Narrowing the scope of audit inspection</u>

Issue

Given the FRC's mission to promote high quality corporate governance to foster investment and the Government's focus on economic growth, the reform programme is an opportunity to consult on and review the appropriate focus of the FRC in meeting both its mission and the objectives set out by Government.

<u>Finalised Proposal 1</u>: The primary focus for FRC regulation should be publicly traded and large private companies (defined as those with a turnover of £500m or more). This would be in line with the FRC's core mission of promoting investment. Although large private companies are, in general, relatively small when compared to listed companies, there is a strong case for recognising their economic importance.

Consultation responses were mixed. A majority of the investor community favoured the proposal, and a minority of that group wanted further narrowing by removing AIM companies from scope. On the other hand, other organisations claimed that the public interest was best served by keeping the public sector and charities within scope.

On balance, given the FRC's mission to foster investment, and the strong support from stakeholders on the benefits of refocusing as stated in this proposal, the FRC will not at this stage make significant change the scope of its activities, but will maintain the dialogue with its stakeholders on the appropriate range of its activities.

Assumptions

Over time, the FRC has become involved in varying degree in inspecting the audits of pension schemes, charities, friendly societies and other entities in addition to publicly traded and large private companies[5].

Costs and Benefits

Following consultation, the FRC regards this proposal as broadly neutral in terms of costs to business.

Benefits: The overall benefits (non-monetised) of clarifying the FRC's scope result from a sharper and clearer focus on the FRC's mission. Although difficult to monetise, the FRC believes that a clearer focus will enable the FRC to focus its oversight on areas which matter most to investment and economic growth. Market research provides the evidence of the economic significance of listed and large private companies.

Risk

The risk associated with this proposal is that entities no longer in scope do not benefit from the independent inspection arrangements operated by the FRC, but are subject to the arrangements operated by the recognised supervisory bodies.

[5] Large private companies are defined in this IA as those with annual turnover above £500m.

Detailed Assessment 2 – An investment focus for the FRC – Narrowing the scope of disciplinary cases

Issue

Given the FRC's mission to promote high quality corporate governance to foster investment and the Government's focus on economic growth, the reform programme is an opportunity to consult on and review the appropriate focus of the FRC in meeting both its mission and the objectives set out by Government.

Finalised Proposal 2: The scope of the FRC's accountancy disciplinary arrangements should be narrowed to cover the quality of work and conduct of accountants in relation to the audit of statutory accounts and assurance reports for the capital markets, leaving other cases of misconduct to the professional bodies.

Following consultation, where mixed views were presented, BIS and FRC have decided that the FRC will continue to consult those with an interest in its work to ensure that the scope of its activities, in relation to conduct, remains appropriate and effective.

Assumptions

The overarching assumption which determines the estimates of this proposal are that the cost of past cases and their number are a reliable base from which to estimate future case costs and case numbers.

Costs and benefits

Costs: This proposal is cost-neutral. The accountancy professional bodies already meet in full the costs of all disciplinary cases involving their members – including those which they deal with through their own disciplinary arrangements and those which are deemed in the public interest and therefore taken forward by the AADB.

To give a perspective on the significance in terms of the costs that the accountancy professional bodies will cover directly rather than through the AADB under this proposal, between 2003/04 and 2010/11, total AADB investigations of cases that would not fall within the future proposed scope have cost approximately £2.2m (cost of five cases up to March 2011) or 31% of the total (total cost of AADB investigations - £7.2m).

Benefits: The key benefit of this proposal is non-monetised and is the clarification the FRC's role as primarily focussed on the efficiency of the capital markets, underpinned by the quality of audit. This will allow the FRC to focus its attention on issues which are most relevant to the functioning of capital markets and the needs of investors. The FRC expects that its refocused activities on conduct will allow it to focus on the outcome of greater quality of corporate governance and reporting which fall under statutory accounting more so than with present arrangements. This benefit is not quantified as it is difficult to link greater oversight with monetary values.

Risk

A potential risk is that the narrowing of scope of disciplinary cases that the FRC undertakes will adversely impact on confidence in standards of behaviour in areas outside audit. The FRC has considered carefully the responses to this proposal, and will keep the policy under review.

Detailed Assessment 3 – Powers delegated to the FRC Board not the operating bodies

Issue

The list of existing statutory powers and references held by the FRC and its operating bodies is in Appendix D. It is proposed that in future most of these powers should be delegated to the FRC Board.

The FRC intends to restructure the organisation on the basis of a main Board and two Board Committees: one concerned with the setting of codes and standards, the other with the conduct of companies and professionals. Most of the powers must be delegated to the FRC Board to enable the restructuring to take place and for the full benefits of the proposal to be realised.

The response to the consultation suggest that most stakeholders regard this as a helpful simplification of the FRC's structure, provided that the new governance arrangements provide the necessary accountability and transparency for decision-making.

Finalised Proposal 3: The preferred option minimises duplication of activity and resource and helps the FRC move to a clearer structure in terms of the two main areas of FRC activity: Codes and Standards and Conduct. The seven operating bodies are reduced to two Committees[6]:

- One of these Committees will cover the FRC's work on codes and standards embracing most of the work of the Corporate Governance Committee, the Accounting Standards Board, the Auditing Practices Board and the Board for Actuarial Standards.

- The other will lead supervisory and disciplinary matters including most of the work of the Financial Reporting Review Panel, the Professional Oversight Board and the Audit Inspection Unit, and the Accountancy and Actuarial Disciplinary Board.

Assumptions

The current structure, because of its complexity, involves a degree of cost, duplication and delay. Different parts of the organisation operate under a variety of delegated powers, which can inhibit the free exchange of information, and they address specific subject areas rather than cross-cutting issues.

The FRC assumes that the savings associated with the reduction in total fees for operating body members will not be realised in full in the first year (2012/13). It therefore assumes that savings will be 50% of £260k in 2012/13 and 100% of that figure from then on.

A significant amount of the total savings is estimated on the basis that the streamlined structure will involve fewer operating body members and meetings which will reduce the costs associated with the current complex structure while enhancing the FRC's effectiveness. Fewer meetings will also have a knock-on savings in terms of reduction in administrative fees. The assumptions used in reaching these figures are below.

[6] See Annex C for a comparison of the current and new structure.

Currently, member fees are £900k (2010/11). The FRC estimates a reduction of 20% of this cost based on fewer members required to operate within the new structure. The estimated annual saving from this reduction is **£180k**.

Costs and benefits

Costs: The FRC budget provides for a one-off cost of approximately **£480k** (see Table 2 below). The FRC Plan & Budget 2011/12 explained the FRC's intention to accommodate the costs through a small reduction in the FRC's general reserves. At 31 March 2011, the FRC General Fund showed a balance of £3.4m. The reserve is funded through the FRC's voluntary funding arrangements.

Table 2 Budgeted cost of streamlining the FRC structure

	Estimated cost of streamlining the FRC structure	**Budget £k**
1.	Staff-related costs	180
2.	Legal	50
3.	External support	150
4.	IT/Support	100
	Total	**480**

(Source: FRC internal data)

Familiarisation costs to business are not expected to be significant. A simplified structure will be much easier for businesses to understand than the current arrangements.

The on-going costs of the reformed structure are estimated to be less than those of the current structure. The setting-up of these groups and panels will be met from the 2011/12 budget.

There are no additional costs associated with the powers being delegated to the FRC Board. This change will facilitate the wider FRC reforms and underpin its enhanced effectiveness as a regulatory authority.

Benefits: The effect of changing the structure of the FRC as well as placing powers at Board level will make the FRC more effective in carrying out its mission to foster investment. The biggest prize to be secured through this change is the ability to influence more effectively the overall impact of the UK regulatory regime for corporate governance and reporting and EU and global regulatory developments which impact on UK market participants.

The monetised benefits identified as savings are modest and will accrue to the FRC and in due course the FRC's funding groups. Respondents to the consultation noted the relatively small monetary savings the FRC envisages in streamlining its structure and commented that the decision how to proceed should be based on the wider impact of the proposal. The FRC's rationale for restructuring is not driven by cost savings. Following consultation we further elaborate on the non-monetised benefits below.

The non-monetised benefits include a better understanding for the FRC of the risks across the market which will benefit market participants (investors, auditors and listed and non-listed companies) through a more effective regulatory framework. By placing powers at the FRC Board level, we expect the Board to play a much more visible role in influencing dialogue on corporate governance and reporting, especially in international fora.

In terms of monetised savings, the figures are relatively modest. The streamlining of the FRC structure will create efficiency savings through a reduction of the number of decision-making groups. Currently, the costs operating body members are in the order of £900,000 per annum – excluding FRC central costs. The FRC expects a reduction of 20% in member remuneration as a result of the reduction in the number of operating bodies. This results in a saving of **£180k (£900k x 0.2).**

There are also additional savings, expected to be around **£60k** which is based on a estimate that there will be 20 fewer meetings per year – saving 1,400 man-hours (based on two 35 hour-weeks) assuming costs of £55 per hour. This figure reflects a combination of costs for senior professional staff (including mainly senior and highly experienced accountants and actuaries) and administrative staff.

Total savings based on these two assumptions are, therefore, **£240k (£180k + £60k)**.

Table 3 sensitivity analysis

Scenario	**No. of Board meetings saved**	**Estimated savings**
Low	10	£20k
Best	20	£60k
High	30	£100k

The sensitivity analysis in Table 3 below is based on the uncertainty over the number of meetings the FRC can save as result of streamlining its governance and structure. This analysis was made up of £80k administrative savings which has now been brought down to £60k following consideration of the additional advisory council meetings. The high and low estimates have been lowered at the same quantum.

In 2011, the FRC had 61 full operating body meetings, excluding the FRC Board. This does not include the committee meetings that sit under the operating bodies: there is an expectation that there will still be a number of meetings of supporting groups and committees associated with the new structure.

Risk

The key risk associated with this option is that the FRC does not maintain the high standards of engagement with market participants and international influence that are a feature of the present arrangements. This risk was raised at consultation and are dealt with here.

The FRC is alert to this risk and will take appropriate steps to ensure an effective transition to the new structure and a focus on the FRC's engagement with market participants – including investors, business and the professional bodies – and a strong focus on the FRC's role in influencing EU and global developments that impact on corporate governance and reporting in the UK. Advisory Councils will have a key role in this.

The FRC Board and the Codes and Standards Committee will be advised by three Councils covering corporate reporting (both accounting and narrative reporting), actuarial work and auditing and other assurance work. These are an important part of the new decision making structure.

The Advisory Councils, in relation to their areas of expertise, and the Codes and Standards Committee, in relation to corporate governance matters, will be responsible for providing important input that adds to strategic and technical thinking. The document "Government and FRC Response to the Joint Consultation on Reforming the FRC" has further detail of the functioning of the new structure.

Following consultation, additional risks were identified with this proposal. The FRC has considered these risks carefully. They are all relevant risks to the restructuring of the organisation. The additional risks and our response:

- Risk: the new structure may fail to attract experts of sufficient calibre such as it does already.
    - Response: The FRC recognises the important work of its non-executive members and the importance of attracting the right calibre of people to the organisation. The new structure will be led by individuals of high standing. By placing powers at the Board level, the FRC will be able to attract internationally recognised people to the Board, as is currently. The Committees and Advisory Councils will have significant roles that will attract experts of high standing.

- Risk: the loss of technical expertise with powers residing at Board level.
    - Response: the Advisory Councils will be staffed by recognised experts in their field. On taking advice when setting standards, the Board will take advice from the executive and advisory councils before taking a decision. This should ensure that the necessary technical view, alongside the views of technical experts at Board level, are considered sufficiently. Following consultation, the FRC will ensure advantages in strengthening the role and contribution of Advisory Councils. The arrangements for Advisory Councils laid out above will ensure transparency of roles, flow of advice and appropriate consideration of technical input.

- Risk: the removal of the Accounting Standards Board as a subsidiary decision-making body of the FRC may affect the ability of the UK to influence international accounting standards.
    - Response: BIS and FRC agree that it is vital for the UK to be able to represent its views at the international level. We believe, that the FRC Board with its members of international standing and powers backed by statute will be an even more effective representative body of UK interests in international fora. The Board members who chair Advisory Councils will be responsible for developing an influencing strategy and personally contribute to its delivery. The Board Committee will review the effectiveness of policy positions on international matters and the impact being achieved. We will seek representative positions where possible, including on groupings of national standard-setters and advisory groups such as

Detailed Assessment 4 - Powers to require the professional bodies to apply sanctions

Issue

It is now firmly established that professions should be subject to independent oversight in respect of the work they do in the public interest.

This assertion is based on the general consensus of the community of regulators and market participants within which the FRC operates. As an example of the view of market participants, PricewaterhouseCoopers made the following announcement: "*Over the last several years, regulation of the auditing profession has evolved substantially with independent oversight of audit firms now in place in many jurisdictions around the world. Independent oversight has made an important contribution to audit quality and investor confidence in financial markets*." [7]

This proposal will empower the FRC to require professional bodies to use the sanctions they already have. It is proposed that the requirement is added to the existing arrangements under which the FRC oversees the recognised supervisory bodies. Currently the FRC can only make a recommendation to the supervisory bodies when it feels there is a need for them to take action. This can compromise the effectiveness of the disciplinary framework.

Market analysis

Audit represents a significant cost to UK business – estimated at £2.1 billion[8]. The FRC is currently considering ways of enhancing the usefulness of audit.

Evidence from the Audit Inspection Unit shows that although standards of auditing in the UK are generally good there are areas for improvement. Of the 11 audits (13.5%) requiring significant improvements in 2010/11, six were listed or AIM companies and the audits of three unlisted subsidiaries of overseas banks (out of 10 bank and building society audits reviewed) were assessed as requiring significant improvements[9].

Finalised Proposal 4: To enable the FRC, through agreed arrangements with the professional bodies, to require the professional bodies to impose sanctions for poor quality audit, rather than to recommend action as at present.

Such independence does not mean that the FRC want anything other than to work closely with market participants, including the professions. It is important that we and the professional bodies with regulatory responsibilities work together in ensuring high standards are achieved.

This proposal is not based on a perception that there is an inherent need to increase the number or nature of sanctions that are applied. Standards of auditing in the UK are generally

[7] See http://www.pwc.com/gx/en/press-room/2011/major-global-accing-nets-support-announcement-of-coop-agreement.jhtml

[8] See link for source: Cost-effectiveness of FRC regulation: http://www.frc.org.uk/about/cost_effective.cfm

[9] See the AIU Annual Report: http://www.frc.org.uk/images/uploaded/documents/AIU%20Annual%20Report%202010-11.pdf

high, underpinned by the highly regarded UK professional bodies. It is intended to strengthen the FRC's independence as a regulatory authority and thereby enhance the overall effectiveness of the present regulatory arrangements.

Assumptions

The FRC does not believe that this proposal will require additional resource. The FRC currently operates the monitoring arrangements on which the proposed sanctions would be based and the sanctioning would be undertaken by the supervisory bodies under the arrangements which they currently operate. The FRC would operate the enhanced arrangements on the basis of its existing resources.

Costs and benefits

Costs: The FRC does not expect there to be an additional cost or significant transitional costs associated with this proposal. Sanctions will be determined by the proposed Conduct Committee's Monitoring Committee.

This proposal would allow the FRC the ability to determine proportionate sanctions within the same remit as the professional bodies and require them to impose those sanctions, instead of voluntarily acting on the FRC's recommendation, thereby enhancing the independent oversight of the regulation of audit. The choice of sanction to be imposed would depend on the seriousness of the shortcomings found and might include a requirement to take corrective action, training and/or the imposition of conditions on a firm or individual's audit licence, the suspension of an audit licence or even the removal of 'responsible individual status' for that particular firm. These powers are already used by professional bodies.

The FRC will establish safeguards to ensure that any decision to require the supervisory bodies to impose sanctions is reached fairly.

Benefits: The key non-monetised benefit is to enhance the FRC's ability to operate as the UK's independent audit regulator with an appropriate degree of independence from those it regulates – and hence play as effective a role as possible in maintaining high standards of audit to underpin the quality of information available to the capital markets. It also clarifies the respective roles of the FRC and the professional bodies.

<u>Market Research</u>

Financial Services Authority research[10] shows that firms operating in retail markets increase their rate of non-compliance more with a reduction in penalties than a reduction in the rate of detection. Overall, the benefit of greater independence for the FRC will be to maintain an effective and proportionate sanctioning regime.

Respondents to the consultation raised a number of questions about how the sanctions would work in practice.

Risk

The main risk for the FRC is that the enhanced independence involved in the sanctioning arrangements does not secure improvements in audit quality. The FRC will monitor carefully the impact of the new arrangements.

---

[10] Financial Services Bill - Impact Assessment of additional powers for FSA to suspend and fine certain persons

Detailed Assessment 5 – Enhanced independence for FRC disciplinary arrangements

Issue

The proposal is for the FRC to be able to make its own rules for disciplinary arrangements without having to obtain agreement from professional bodies (referred to as Participants in the scheme).

In its Feedback Statement published in October 2009 following the last review of the Accountancy Scheme, the AADB expressed concern at the amount of time taken to finalise its proposals (approximately two years). It commented that the need to obtain the agreement of each of the Participants in order to amend the Accountancy Scheme had had significant implications for the speed, efficiency and effectiveness with which changes could be implemented.

Finalised Proposal 5: To give the FRC power to make changes to the disciplinary schemes without the requirement to seek approval from professional bodies. The current arrangements limit the FRC's ability to act independently as it must agree the content of a scheme with Participants before it can make any changes.

The FRC would still consult extensively with the professional bodies when reviewing the disciplinary scheme.

Assumptions

The FRC assumes, based on past experience, that there will not be more than 2 scheme reviews over the next ten years. Since 2004, there has only been one scheme review. The costs savings are based on past scheme reviews.

The savings generated by the proposal are assumed to be replicated by Professional Bodies as they will spend a similar amount of resource to the FRC in negotiating, planning and agreeing a scheme review.

Costs and benefits

Costs: The FRC does not expect there to be additional costs arising from this proposal. The proposal will ensure that the FRC consults proportionately with a broad base of stakeholders on the same basis rather than running a two separate consultations.

Benefits: Scheme reviews are infrequent and are unlikely to exceed two every 10 years. The benefit of this proposal is calculated over the lifetime of the proposal (10 years) and then annualised.

The estimated savings that would arise from two scheme reviews over the next ten years is expected to save around £160k for the FRC and £160k for the market participants. Costs are based on the experience of the most recent review.

Table 4 – FRC external legal fees associated with scheme reviews

Year	2008-09 (£k)	2009-10 (£k)	2010-11 (£k)	2011-12 (£k)	Total (£k)
Review costs	91.2	33.6	8.3	-	133.1
Case Settlement/Research	-	-	20.3	-	20.3
Prosecution/test guidance	-	-	-	7.2	7.2
Total	91.2	33.6	28.6	7.2	160.6

(Source: FRC internal data)

The latest review[11] was consulted on in January 2008 and finalised in October 2009. Based on this example, the FRC could have completed this review one year earlier if it had the power to do so without agreement from the profession.

The FRC assumes that it will save 50%[12] of the costs of a review by speeding up the process through this proposal. Given an assumed cost of £160k per review on the present basis, the total saving would, therefore, be £160k over 10 years which is £16k per annum (£160k X 2 / 10). This is doubled to reflect the savings that would be achieved for market participants, which equates to **£32k** per annum.

The other significant benefit is the additional confidence in the disciplinary arrangements that may come about due to a perception that there is enhanced independent in managing the FRC's disciplinary arrangements. This should support the overall package in enhancing confidence in capital markets and by doing so fostering investment.

Risk

Engagement and consultation with the professional bodies is crucial to the success of the disciplinary arrangements. The key risk of this proposal is that the FRC is perceived to implement unjustifiable changes to its disciplinary scheme without the support of the profession. This would pose a reputational risk to the FRC. The FRC proposes to manage this risk by conducting consultations with the professional bodies, market participants and other stakeholders prior to taking decisions about any changes to disciplinary rules and procedures.

[11] See link for consultation document: The AADB Accountancy Scheme Review http://www.frc.org.uk/documents/pagemanager/aadb/Accountancy%20Scheme%20Review.pdf

[12] There will continue to be negotiations with Participants during scheme reviews to ensure that the process is properly transparent and accountable. This will require an appropriate amount of time for consultation.

Detailed Assessment 6 - Powers for early resolution of disciplinary cases

Issue

Public confidence in the effectiveness of the disciplinary arrangements could be enhanced by swifter conclusions to cases provided that the arrangements remain fair and transparent.

AADB disciplinary cases generally take between one and five years to come to a conclusion. Several factors affect the time taken to reach disciplinary outcomes, some of which are outside the control of the AADB. This creates costs for the FRC, professional bodies and those under investigation both in terms of money and reputation. If the FRC were able to take disciplinary action without the need for a disciplinary hearing before a tribunal, the financial and reputational cost of disciplinary cases may be reduced whilst still maintaining an effective enforcement mechanism.

Finalised Proposal 6: To enable the FRC to take a more proportionate approach to cases, where it may be reasonable to seek resoultion instead of the current arrangement where each case must go to a full public tribunal.

Assumptions

The FRC estimate significant savings from reducing the time taken to bring disciplinary cases to a conclusion. The accuracy of the estimates is based on the past experience of the AADB in carrying out the requirements of its disciplinary scheme. The range is wide to reflect the fact that these are new powers and that case costs range widely from case to case.

Costs and Benefits

Costs: The FRC does not expect there to be any additional costs as a result of gaining powers to conclude cases without a full disciplinary hearing. It expects the costs of disciplinary cases to reduce significantly.

The settlements could be in a variety of forms, including: monetary fines, agreements to take actions. The form will depend on the nature of the problem and the details of negotiation between the FRC and defendants. Whatever their form, the cost will be less than the existing arrangement. If the costs were higher than perceived cost of going to full tribunal then this approach would be taken.

Benefits: There are two elements to the savings:

Savings in relation to the cost of tribunals

The FRC estimates that the ability to resolve cases without going to tribunal will save the cost of 3 tribunals over the 10 year policy period. Average tribunal costs of the AADB (which are additional to the other costs associated with a particular case) are £750k. Total savings of the 3 tribunals would, therefore, equate to £225k per annum over 10 years (£750k X 3 /10). Sensitivity analysis of this includes a low estimate of 1 tribunal being saved and a high estimate of the cost of 5 tribunals being saved. The savings range based on these assumptions is between £75k per year and £375k. The best estimate is **£225k** saving per annum. Market participants are assumed to make a similar saving. Total saving is **£450k**.

Savings in relation to the cost of preparing for tribunals

In addition to the savings noted above, there would be savings in the substantial costs involved in preparing for tribunals.

Using the same assumptions for the reduction of the number of tribunals as above, the total annual saving would be £150k per year. Market participants are assumed to make a similar saving, resulting in a total annual saving of **£300k**.

Total estimated savings from avoiding tribunals and reducing the length of tribunals are, therefore, **£750k** per annum **(£300k + £450k)**.

Risk

There is a risk in estimating the benefits in terms of cost reduction. The actual reduction may be lower than estimated. However, based on past experience, this is unlikely as the public hearing stage of disciplinary cases usually lead to significant costs.

A minority of consultation respondents suggested that the risk weighting for this proposal was insufficient and that the FRC should not assume early settlement of cases. Based on the significant number of respondents who were in favour of this proposal an agreed with the merits for the case as set out in the consultation stage impact assessment, the initial analysis remains unchanged.

Although there was a significant degree of support for creating procedures that would allow for early resolution, there were concerns that this might lead to a loss of transparency. To ensure that this risk does not materialise, the FRC will make clear that the conclusion of all disciplinary cases will be published, irrespective of whether a disciplinary sanction has been imposed following a public hearing.

Detailed Assessment 7 - Powers to Sanction Professional Bodies

Issue

The Secretary of State for Business, Innovation and Skills currently delegates to the Professional Oversight Board of the FRC his function to oversee the direct regulation of statutory auditors by professional accountancy bodies recognised for this purpose. Part of the oversight function is to detect and correct non-compliance by a recognised body with its statutory obligations.

The FRC currently has two statutory enforcement powers. It can remove a body's recognition to offer an audit qualification and/or to supervise auditors; and it can apply for a court order, which, if granted, would set out what a body must do to meet its statutory obligations.

The difficulty with both powers is that they are essentially nuclear options, which are not proportionate to most common issues faced by the FRC in exercising oversight over the bodies. The FRC has not used these powers in the past.

Whilst the recognised bodies generally take the FRC's findings and recommendations seriously, a more graduated range of powers should sharpen their responses, in particular the timeliness of actions, and would establish more firmly the independence of the regulator from the regulated. Moreover, the lack of proportionate FRC powers gives a perception that the oversight body is too dependent on the goodwill of the regulated bodies to bring about change.

<u>Finalised Proposal 7:</u> This proposal will enable the FRC to:

- Issue an enforcement order, without the need for a court order. There should be a right of appeal for the professional body against an enforcement order.

- Impose a fine.

The availability of these limited and proportionate sanctions as an alternative to the present far stronger powers would enable the FRC to tailor its response to the specific circumstances of a case.

An enforcement order could be made in a number of different ways. Four examples are set out below:

- to require a professional body to carry out a specified number of monitoring visits to audit firms within a given period,
- to carry out an external moderation of the quality of its examinations by a specified date,
- to restrict the ability of a supervisory body to supervise new auditors until it had satisfied the regulator that it had made improvements to regulatory systems;
- to prohibit a qualifying body from enrolling new students for the audit qualification until it had brought its examinations up to an acceptable standard.

Costs and Benefits

Costs: The FRC considers that it would be unlikely in practice to deploy the more limited sanctions. The main difference from at present is likely to be the perception of stakeholders of a quicker and more effective response from the supervisory bodies.

There may be small costs to the professional bodies depending on the type of sanction and circumstances under which it has been administered. The professional body (and firm or individual, if relevant) may also suffer reputational damage. This may lead to further monetised losses which cannot be estimated here.

Benefits: This will enhance the FRC's independence from those it regulates and so will be more able to make changes which are in the public interest and beneficial to capital markets as a whole.

The FRC will be more effective in deterring non-compliance with the statutory obligations on the recognised bodies, which will in turn increase compliance of market participants and the quality of audit. Given the value of the cost of audit is around £2.1bn per annum[13], the FRC estimates that even incremental increases in the quality of the regulation of audit by the professional bodies which results from the FRC gaining a more proportionate range of powers would outweigh the costs of sanctions.

Both professionals and investors depend on an effective regulatory framework to maintain appropriate standards for professionals and investors to have confidence in. The quality of audit can have a significant influence over the behaviour of market participants. By enhancing the FRC's independence, market participants should benefit from a regulatory regime which is more independent through greater confidence in the quality of audit.

These benefits are not possible to monetise.

Following consultation, respondents made a number of suggestions as to how the sanctioning regime would work in practice. In particular, they noted the importance of an appeals process and the need for transparency to maintain confidence. BIS and FRC agree, and one will be provided.

Risk

The benefits relate to greater perceived independence. There is a risk that the changes are not seen to enhance FRC independence. Given the support for this proposal from consultation respondents, this is not considered likely to materialise.

[13] See link for source: Cost-effectiveness of FRC regulation: http://www.frc.org.uk/about/cost_effective.cfm

5. Option 2 – Maintain the FRC's current structure and powers

The do nothing option has been considered as the baseline against which to measure the impact of other options. It considers the deficiencies in the current structure and set of powers and also highlights some of its benefits. This option has been considered as is standard in IAs

The inefficiencies and other problems of the current structure are made clear throughout the preferred option. This option would leave the FRC with its current set of powers and structure. It would not reduce the risk of information asymmetry and continue to impose unnecessary costs on market participants. This would result in a less effective organisation than envisaged in the preferred option, where the benefits of the overall package outweigh the associated costs and risks.

Stakeholder feedback on the FRC's structure

As referenced in the preferred option, feedback from FRC stakeholders shows the difficulty of understanding how the FRC operates.

From 2005 to date, the FRC has commissioned an independent survey from Ipsos MORI of its effectiveness. Although the published data from these surveys (included in the FRC's Annual Reports) has suggested general support for its activities, levels of understanding of its role among investors in particular, has been relatively low. The comments from stakeholders collected from Ipsos MORI alongside the headline data suggest that there is limited understanding of the FRC's structure among the investor group in particular – a group with which the FRC is seeking to engage more closely.

Supervisory and disciplinary powers

As this final stage impact assessment has identified in its preferred option (Option 1), there are number of drawbacks within the FRC's current set of powers. Under this option, the FRC's independence from the profession and its ability to sanction would remain limited and disproportionate. The efficiencies identified in the preferred option would not be achieved.

6. Option 3 - Streamlined structure with licensing arrangement

This option includes the proposal to sharpen the focus and streamline the governance and structure of the FRC as in Option 1. However, instead of the proposals for independence and proportionate sanctions, this option proposes a licensing arrangement. The FRC considered this option and took the view that the costs of operating a licensing regime, both for the FRC and for the market, would be disproportionate to the benefits, particularly in comparison to the Preferred Option. None of the consultation respondents supported this option as a viable alternative. The finalised proposals which make up part of this option are:

Investment focus for the FRC's regulatory activities

- **Finalised Proposal 1 –** An investment focus for the FRC's activities – narrowing the scope of audit inspection.

The FRC could still focus its activities in line with its mission as in Option 1. The issue, rationale, policy objectives, sub-options and costs and benefits are the same as in Option 1.

- **Finalised Proposal 2 –** An investment focus for the FRC's activities – narrowing the scope of disciplinary cases.

Under the licensing arrangement, the FRC could still narrow the scope of its disciplinary cases to audit and leave other issues to the professional bodies.

Streamlined governance and structure

- **Finalised Proposal 3 –** Powers with the FRC Board; not the Operating Bodies.

Under a licensing regime, the FRC would still benefit from streamlining its structure and governance as outlined in the preferred option. The issue, rationale, policy objectives, sub-options and costs and benefits are the same as in Option 1.

Licensing arrangement

- **Finalised Proposal 4 –** Powers to operate licensing regime

<u>FRC operates a licensing arrangement:</u> In addition to the licence necessary for statutory audit work from the relevant RSB (see below), firms and individuals undertaking audits of and other assurance work for public interest entities would be required to secure a separate licence from the FRC. Under this option, firms and individuals that fall within the public interest remit would have to:

- Apply for authorisation from a professional body and the FRC
- Be subject to additional registration arrangements which fall outside of their existing arrangements with the professional bodies.

The FRC would have the authority to receive direct reports from its audit monitoring unit and to withdraw, suspend or place conditions on the specific licences granted to audit firms and/or individuals.

There are five Recognised Supervisory Bodies (RSBs) in the UK recognised to register and supervise audit firms in line with the requirements of Schedule 10 to the Companies Act 2006. These are:

- Association of Authorised Public Accountants (AAPA)
- Association of Chartered Certified Accountants (ACCA)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Institute of Chartered Accountants in Ireland (ICAI)
- Institute of Chartered Accountants in Scotland (ICAS)

Requirements as outlined in Schedule 10 of the Act mean that RSBs must have procedures in place to register and de-register statutory auditors and supervise work undertaken by these individuals and firms. The RSBs fulfil the requirements of the Act through four main processes; audit registration, audit monitoring, arrangements for the investigation of complaints, and procedures to ensure that those eligible for appointment as statutory auditor continue to maintain an appropriate level of competence.

A licensing arrangement for the FRC would be substantially different from Option 1. As a licensor, depending on the detail of the arrangement, the FRC could have the power to sanction audit firms and individuals directly without reference to the Professional Bodies. Such a power would, significantly limit the regulatory role of the professional bodies (depending on whether audit firms continued their existing licence for non-PIE work) as regulators of organisations that fall within the scope of the FRC. Under this option, the FRC would no longer have the role of independent oversight of Professional Bodies in relations to its work on Public Interest Entities. It would be a direct regulator of audit firms. The FRC believes that would negate the professionalism and quality of work carried out by Professional Bodies in relation to public interest entities. As such, the overall costs, in terms of both monetary and non-monetary costs would be justified (see below).

In terms of independence, the FRC would be more independent of the Professional Bodies than with Option 1 as it could make its own licensing rules and carry out the monitoring and enforcement of those rules on its own.

Costs and Benefits

The cost and benefit analysis of this option is not detailed at great length as the costs associated with operating a licensing arrangement are considered disproportionate to their benefits. This is largely because of the duplication of activity already undertaken by professional bodies and because the proposals for independence and proportionate sanctions in Option 1 are achieved through savings.

Under this arrangement, the FRC would have to register and provide licences and carry out stringent investigations for 76 firms. These are audit firms which audit the listed and large private sector companies.

In the United States of America, the Public Company Accounting Oversight Board (PCAOB) operate a licensing arrangement. The cost of registration and inspections in 2010 was approximately £58m in 2010 (assuming exchange rate of 1 USD = 0.6406 GBP in 2010) which equates to approximately £25k per audit firm for each of the 2,397 audit firms registered at the PCAOB. Taking PCAOB costs, the cost of operating the UK licensing regime could be approximately £1.9m per year (76 x £25k)[14]. However, the FRC regard this as the upper limit,

[14] see PCAOB Annual Report http://pcaobus.org/Pages/default.aspx

and is not able to provide further detail of costs without having any experience or precise costs of operating the regime. Any costs associated with the licensing regime would be recouped by the FRC through a licensing fee which, in the case of audit firms, it could apply in addition to the levy.

However, based on the PCAOB upper limit and the lower limit of operating a pure licensing function in addition to current activities, the best estimate (see table 4 below) is **£1.15m per year**. The rationale for this is that the FRC would expect to incur additional costs over and above licensing. As a licensor of audit firms, it may feel it has to undertake more frequent and rigorous inspections which would mean higher regulatory costs. The FRC may also wish to further invest in the area of research and evidence gathering to better support its new role of direct regulator. Overall, the FRC would not expect to create a licensing regime that was as costly as the PCAOB, but it is likely that it would incur costs beyond the administrative costs of setting up and maintaining a licensing function.

Licensing regime	Cost estimate per year
Current FRC + registration	£200k
Current FRC + registration + additional inspection, enforcement and other costs (Best estimate)	£1.15m
PCAOB style arrangement	£1.9m

If the FRC were to merely maintain an additional registration function and keep to its current number and rigour of inspection and enforcement activities, the cost would be approximately £200k per year. This is based on the FRC's experience of setting up third country audit registration scheme and is made up of costs in setting up a database and maintaining that database.

The total cost of the PCAOB style arrangement would depend on the number of additional inspections and reviews under the new regime. For example, the PCAOB inspect firms that issue audit reports for more than 100 issuers every year – it inspected nine such firms in 2010[15]. If the FRC were to adopt the same rule under the licensing arrangement, it would have had to undertake four such inspections every year. Costs would also have to fund increasing FRC investment in supporting services such as research and additional staff. It is not possible to quantify these costs without further detailed analysis.

Under this option, the FRC's current voluntary funding arrangement would have to be reviewed in order to ensure that it could deliver a significant additional regulatory function. This would remove the benefits of the current voluntary arrangements which are cost-effective and have operated effectively for a number of years.

<u>Comparison of the licensing regime with the preferred option</u>

[15] *ibid*

In comparison to the licensing arrangement, the preferred option achieves greater proportionality of independence and sanctions, whilst also reducing rather than increasing costs and creating savings for business. The preferred option builds on the current system of regulation and oversight whereas Option 3 may have unintended consequences in regulation. In addition, Option 3 was not supported by any of the respondents to the consultation.

The FRC believes that the quality of service provided by the audit industry does not require this level of costly intervention which could have significant unintended consequences such as causing a gradual shift away from principles based regulation toward rules based regulation. This shift would mean the loss of the benefits of principle based regulation. These include

- flexibility in meeting the different needs of companies;
- standards driven by consensus not law;
- culture of encouraging better corporate behaviour and not box ticking; and
- an easily amended regime.

The licensing regime would require the FRC to replicate, to some extent at least, the costs of the audit registration arrangements. The FRC would be required to set up a system whereby it registered firms that it licensed.

In addition, it would be reasonable to expect that the FRC would have to conduct more investigations at audit firms than is currently the case to be confident that its licences are owned by competent audit firms. This would raise the costs of regulation.

7. Specific Impact tests

The reform proposals of the FRC do not have a direct impact on any of the following:

- Statutory equalities duties;
- Economic impacts on competition and small firms;
- Environmental impacts such as greenhouse gases and wider environmental issues;
- Social impacts such as health and well-being, human rights, the justice system or rural proofing; and,
- Sustainable development.

However, notwithstanding the points made above, high quality corporate governance and reporting help underpin high standards of behaviour and informed judgements by investors and therefore have wider consequences which may have relevance to these issues. The FRC is in not in a position to make any value judgements on these impacts as they can only be observed in areas of the economy beyond the direct monitoring activities of the FRC. The additional monitoring requirements for observing these impacts would be too costly to justify.

There are aspects of FRC regulation that affect individuals. In all its activities the FRC has regard to its procedures, which are designed to be fair and provide appropriate safeguards, and conform to the principles of natural justice and the Human Rights Act. None of the proposals on which the Government and the FRC are consulting will change that position.

The FRC will continue to have regard to the economic importance of small firms.

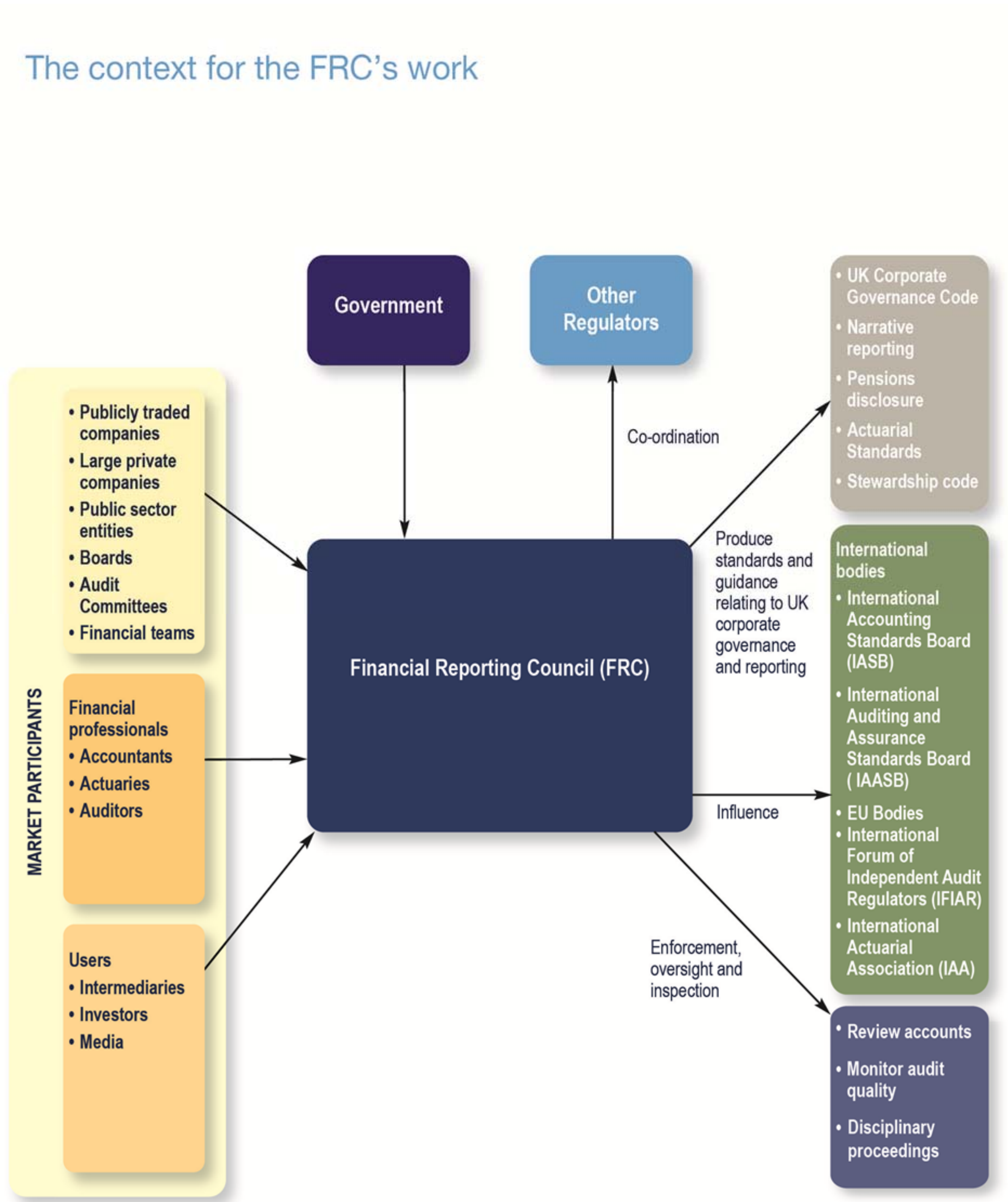
Annex A – Post Implementation Review (PIR) Plan

Basis of review: As part of its commitment to the principles of good regulation, the FRC is committed to reviewing the proposals in this reform package to ensure that they meet their objectives at a reduced overall cost to business.
Review objective: The objective of the review will be to check that the overall policy objective is being met and that this is achieved through an overall reduction in costs to business.
Review approach and rationale: The PIR will take place in 2015 (three years after the implementation of the policies) and will include an in-depth evaluation of the proposals as well as using the annual FRC stakeholder survey to determine their response.
Baseline: The baseline will be the costs and benefits associated with the present arrangements. The response to the consultation stage impact assessment has informed the baseline for the Review and the FRC is now confident that its estimates are more robust.
Success criteria: The FRC will monitor the achievement of the proposed savings: but will regard as the most significant measure the perceived effectiveness of the FRC in contributing to the efficiency of the capital markets.
Monitoring information arrangements: The FRC's current arrangements for monitoring the quality of corporate reporting and auditing will form the immediate basis for collecting the necessary data.
Reasons for not planning a review: n/a

Annex B – Cost and benefits of finalised proposals broken down by impact on business

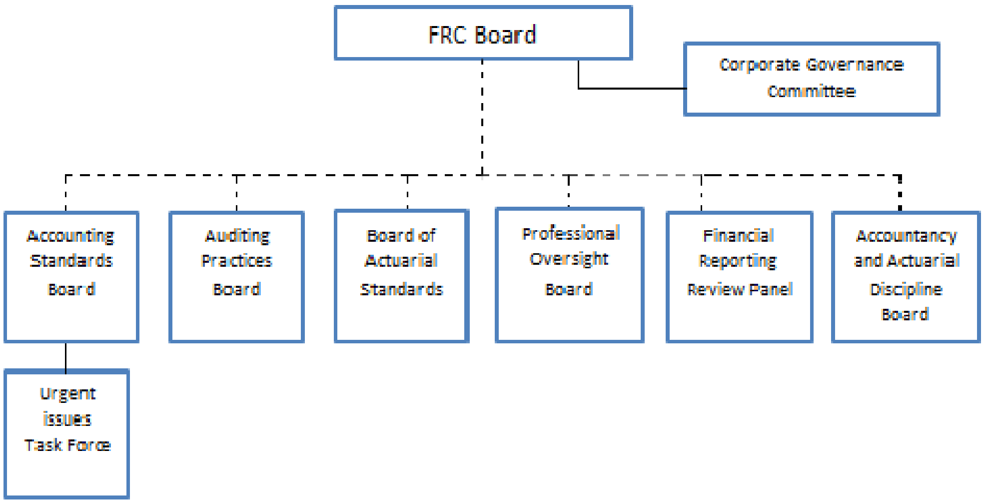
	Finalised Proposals	Costs		Benefits	
		Monetised	Non-monetised	Monetised	Non-monetised
1	Narrowing the scope of audit inspection.	One off cost of implementing the reform programme: £480,000	Decline in quality of corporate governance and reporting in areas outside of focus.	£0	Prioritised activities lead to greater regulatory effectiveness
2	Narrowing the scope of disciplinary arrangements.		Decline in quality of corporate governance and reporting in areas outside of focus.	£0	Prioritised activities lead to greater regulatory effectiveness
3	Powers with the FRC Board; not the Operating Bodies.		Stakeholder resource in understanding new structure and unforeseen problems with transition to new structure.	£260,000 per annum. No savings to business.	Greater strategic oversight allows board to take a holistic view of FRC regulation making it more effective and efficient
4	Powers to require professional bodies to impose sanctions for poor quality audit.		Potential loss of accountability to stakeholders	£0	Enhanced independence of the FRC and greater confidence in the disciplinary arrangements
5	Powers to make rules which it can operate without being required to obtain the agreement of the professional bodies.		Potential loss of accountability to stakeholders. Cost of wrong decisions	£32,000 per annum. Savings to business is half of this: £16,000 per annum	Enhanced independence of the FRC
6	Powers to settle disciplinary cases without Public Hearing.		Potential loss of accountability and confidence in arrangements: Perception that agreements are being made behind closed doors	£750,000 per annum. Savings to business is half of this: £375,000 per annum	Greater confidence in the disciplinary arrangements
7	Powers to sanction professional bodies.		Cost of wrong decisions is high in terms of FRC reputation as well as cost to professional body	£0	Enhanced independence of the FRC
	Total	**£480,000**		**£1,042,000 (of which, £391,000 is savings to business at basic prices per year or 3.4m over 10 years at NPV) of this £375,000 is counted as part of ONE-IN-ONE OUT on annual basis as is £3.3m over 10 years at**	

Annex C – The wider context for the FRC's work



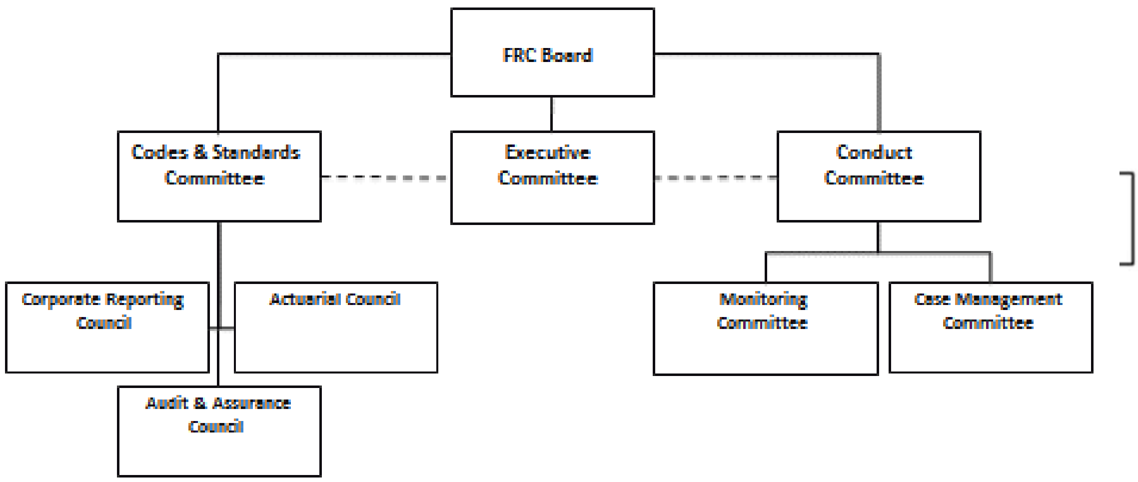
Annex D – Organisational structure

Existing Structure



Proposed FRC Structure

Proposed FRC Structure



Sub-committees of the above are subject to renewal after set time periods

Annex E – The current powers of the FRC and its operating bodies

Function	Responsibility	Powers
Issuing accounting standards.	ASB	The ASB is the prescribed standard issuing body for the purposes of section 464 Companies Act 2006. Further, accountants are expected to comply with accounting standards in accordance with the relevant accountancy body bye laws.
Addressing unsatisfactory or conflicting interpretations of accounting standards.	UITF of ASB	The CCAB bodies (ACCA, CIMA, CIPFA, ICAEW, ICAI, and ICAS) expect their members to observe the consensus reached by the UITF on relevant issues.
Setting standards and giving guidance for the performance of external audit and in relation to the independence, objectivity and integrity of external auditors and providers of assurance services.	APB	The arrangements provided by the APB amount to "appropriate independent arrangements". In order to achieve recognised supervisory body status a supervisory body must participate in appropriate independent arrangements as prescribed in statute – paragraphs 10, 10A and 22 of Schedule 10 Companies Act 2006. The recognised supervisory bodies require registered auditors to adopt APB standards.
Setting actuarial standards.	BAS	MoU between the FRC and the Actuarial Profession supported by provision within the bye laws and disciplinary schemes of the actuarial bodies requiring its members to comply with the standards set by the BAS.
Independent oversight of the regulation of the auditing profession by the recognised supervisory and qualifying bodies.	POB	The Secretary of State has delegated to the POB, in accordance with section 1252 of the Companies Act 2006, his powers under Part 42 of the 2006 Act.
The regulation and registration of third country auditors.	POB	The Secretary of State has delegated to the POB, in accordance with section 1252 of the Companies Act 2006, his powers under sections 1239 to 1247 of, and Schedule 12 to the Act.
Independent supervision of Auditors General	POB	The Secretary of State has appointed the POB as the "Independent Supervisor", under section 1228 of the Companies Act 2006, for the purposes of sections 1229 to 1238 of the 2006 Act.

Monitoring the quality of audits of economically significant entities.	AIU of POB	The arrangements for independent monitoring provided by the AIU amount to "appropriate independent arrangements". In order to achieve recognised supervisory body status a supervisory body must participate in appropriate independent arrangements as set out paragraphs 13 and 23 of Schedule 10 to the Companies Act 2006.
Independent oversight of the regulation of the accountancy profession by the professional accountancy bodies.	POB	The CCAB bodies have given a commitment to consider carefully POB recommendations and either implement them within a reasonable period or give reasons in writing for not doing so.
Independent oversight of the regulation of the actuarial profession by the professional actuarial bodies.	POB	MoU between the FRC and the Actuarial Profession including a commitment by the Actuarial Profession to consider carefully POB recommendations, implement them within a reasonable period or give reasons in writing for not doing so.
Seeking to ensure that the provision of financial information, including directors' reports, by public and large private companies complies with Companies Act requirements.	FRRP	The FRRP is an authorised body under section of the 457 of the Companies Act 2006 for the purposes of section 456 of the 2006 Act.
Monitoring of compliance with accounting requirements of listing rules by issuers of listed securities.	FRRP	The FRRP is the prescribed body under section 14 of the Companies (Audit, Investigations etc) Act 2004.
Providing an independent investigation and discipline scheme for matters relating to accountancy firms or members of the accountancy professional bodies which raise or appear to raise important issues affecting the public interest.	AADB	The arrangements for independent investigation and/or disciplinary hearings provided by the AADB amount to "appropriate independent arrangements". In order to achieve recognised supervisory body status a supervisory body must participate in appropriate independent arrangements as se out in paragraphs 16 and 24 of Schedule 10 to the Companies Act 2006. Further, the bye laws of each of the CCAB bodies provide that their members are subject to the AADB accountancy scheme.
Providing an independent investigation and discipline scheme for matters relating	AADB	The bye laws of the actuarial professional bodies provide that their members are subject to the AADB actuarial scheme. These

to members of the actuarial profession which raise or appear to raise important issues affecting the public interest.		provisions are supported by the Memorandum of Understanding between the FRC and the Actuarial Profession.
Monitoring and maintaining the Combined Code on Corporate Governance and its associated guidance	FRC Board	Compliance with the Code is voluntary, although the FSA's Listing Rule 12.43A requires companies to report on their compliance with the Code. The Irish Stock Exchange has adopted the Combined Code on Corporate Governance as its corporate governance standard, and its Listing Rules require Irish listed companies to comply or explain with the Code."

This publication is also available on our website at www.bis.gov.uk
Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

If you require this publication in an alternative format, email enquiries@bis.gsi.gov.uk, or call 020 7215 5000.

URN 12/701