

<b>Title:</b> <b>Proposals to Reform the Financial Reporting Council</b>  <b>Lead department or agency:</b> Department for Business Innovation and Skills <b>Other departments or agencies:</b> Financial Reporting Council	<b>Impact Assessment (IA)</b>
	<b>IA No:</b> BIS 0323
	<b>Date:</b> 30 /08/2011
	<b>Stage:</b> Consultation
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Secondary legislation
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## Summary: Intervention and Options

### 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, supported by a range of statutory powers. In the aftermath of the financial crisis, the FRC has reviewed its role and identified four constraints on its effectiveness. The scope of its activities is not aligned clearly enough with its mission; its structure is over-complex, with a number of the FRC's powers delegated 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, or equipped with a proportionate range of sanctions. Government intervention in the form of changes to secondary legislation is necessary to enable the FRC to address these constraints effectively.

### What are the policy objectives and the intended effects?

The overall objective is to create a more effective, efficient and independent FRC and minimise the regulatory burdens on market participants. The supporting objectives are to:

- Enhance the FRC's contribution to the efficient operation of the capital markets by focusing its activities on publicly traded and large private companies;
- Enable the FRC Board to focus its activities on key challenges to UK corporate governance and reporting;&
- To contribute more effectively to the quality of auditing in the UK through:
  - o reinforced independence from the accountancy professional bodies
  - o 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:

Option 1 - A set of reforms 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 constraints the FRC has identified 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 significant additional costs on market participants. This options includes proposals from Option 1.

**Will the policy be reviewed?** It will be reviewed. **If applicable, set review date:** 4/2015

**What is the basis for this review?** PIR. **If applicable, set sunset clause date:** Month/Year

<b>Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?</b>	Yes
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**SELECT SIGNATORY Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible SELECT SIGNATORY: \_\_\_\_\_ Date: \_\_\_\_\_

# Summary: Analysis and Evidence

# Policy Option 1

## Description:

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

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-	-	-
High	-	-	-
<b>Best Estimate</b>	<b>0.48</b>	-	<b>0.48</b>

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

The costs associated with the reform proposals would be met from the resources provided by FRC's existing funding groups - the groups subject to the FRC 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.

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

Familiarisation costs to business are not expected to be significant. The sanctions on firms and professional bodies 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	-	-	-
<b>Best Estimate</b>	<b>0</b>	<b>1.33</b>	<b>11.318</b>

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

The main beneficiaries are market participants (from 2012/13 - Y0 in the annual profile) including firms and individuals in the audit market. The most significant benefits identified are in relation to the proposal which allows early settlement of disciplinary cases (£750k a year) and to narrow the focus of the FRC's activities (£280k a year), the proposal to streamline FRC governance (£260k a year) and the proposal to facilitate changes to the disciplinary scheme for accountants (£40k a year).

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

The proposals are expected to strengthen the framework for corporate governance and reporting. This will benefit the UK economy through increased confidence in capital markets generated through the usefulness of information available to market participants in making investment decisions.

### Key assumptions/sensitivities/risks

Discount rate (%)

3.5

These proposals are designed to be effected by secondary legislation and to come in to statute 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: but experience suggests that the ability to settle cases more quickly can be applied in practice and will have the effect of significantly reducing costs to both the FRC and market participants.

<b>Direct impact on business (Equivalent Annual) £m):</b>			<b>In scope of OIOO?</b>	<b>Measure qualifies as</b>
Costs: 0	Benefits: 0.534	Net: 0.534	Yes	OUT

## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			01/04/2012		
Which organisation(s) will enforce the policy?					
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			Yes/No		
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			Traded:		Non-traded:
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: NA		Benefits: NA
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro 0	< 20 0	Small 0	Medium 0	Large 100%
Are any of these organisations exempt?	No	No	No	No	No

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties<sup>1</sup></b> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	34
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	No	34
Small firms <a href="#">Small Firms Impact Test guidance</a>	No	34
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	34
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	34
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	No	34
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	34
Justice system <a href="#">Justice Impact Test guidance</a>	No	34
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	34
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	34

<sup>1</sup> Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

## Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

### References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	FRC Annual Report 2010/2011 <a href="http://www.frc.org.uk/images/uploaded/documents/FRC%20Annual%20Report%202010-11%20final2.pdf">http://www.frc.org.uk/images/uploaded/documents/FRC%20Annual%20Report%202010-11%20final2.pdf</a>
2	Companies Act ( <a href="http://www.legislation.gov.uk/ukpga/2006/46/contents">http://www.legislation.gov.uk/ukpga/2006/46/contents</a> )
3	HMT Financial Services Bill – IA of additional powers for FSA to suspend and fine certain persons ( <a href="http://www.hm-treasury.gov.uk/d/fin_bill_ias.pdf">http://www.hm-treasury.gov.uk/d/fin_bill_ias.pdf</a> )
4	Financial Services Bill - IA of Extension of FSA Information Gathering Powers – November 2009 (final proposal) ( <a href="http://www.hm-treasury.gov.uk/d/fin_bill_ias.pdf">http://www.hm-treasury.gov.uk/d/fin_bill_ias.pdf</a> )
5	FRC funding levies - <a href="http://www.frc.org.uk/about/funding.cfm">http://www.frc.org.uk/about/funding.cfm</a>
6	Plan for Growth – HM Treasury ( <a href="http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf">http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf</a> )
7	Cost-effectiveness of FRC regulation: <a href="http://www.frc.org.uk/about/cost_effective.cfm">http://www.frc.org.uk/about/cost_effective.cfm</a>
8	Fast Track – Top Track 100 - <a href="http://www.fasttrack.co.uk/fasttrack/downloads/2010toptrack100.pdf">http://www.fasttrack.co.uk/fasttrack/downloads/2010toptrack100.pdf</a>
9	House of Lords Economic Affairs Committee - <a href="http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-committee/inquiries/auditors-market-concentration-and-their-role/">http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-committee/inquiries/auditors-market-concentration-and-their-role/</a>
10	FRC Hampton Review - <a href="http://www.bis.gov.uk/assets/biscore/corporate/docs/f/10-690-financial-reporting-council-hampton-report">http://www.bis.gov.uk/assets/biscore/corporate/docs/f/10-690-financial-reporting-council-hampton-report</a>

### Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

#### Annual profile of monetised costs and benefits\* - (£m) constant prices

	Y <sub>0</sub>	Y <sub>1</sub>	Y <sub>2</sub>	Y <sub>3</sub>	Y <sub>4</sub>	Y <sub>5</sub>	Y <sub>6</sub>	Y <sub>7</sub>	Y <sub>8</sub>	Y <sub>9</sub>
<b>Transition costs</b>	0.48	-	-	-	-	-	-	-	-	-
<b>Annual recurring cost</b>										
<b>Total annual costs</b>	0.48									
<b>Transition benefits</b>	-	-	-	-	-	-	-	-	-	-
<b>Annual recurring benefits</b>	1.2	1.33	1.33	1.33	1.33	1.33	1.33	1.33	1.33	1.33
<b>Total annual benefits</b>	1.2	1.33	1.33	1.33	1.33	1.33	1.33	1.33	1.33	1.33

\* For non-monetised benefits please see summary pages and main evidence base section

## Evidence Base (for summary sheets)

### Proposals to reform the FRC – Supporting Analysis

Section	Content	Page
1	<u>Introduction</u>	6
2	The case for change	7
3	Options considered	10
4	<u>Option 1 – Streamlined structure/Reformed powers (Preferred option)</u>	14
5	Option 2 – Do nothing	31
6	Option 3 – Additional powers to licence public interest audit	32
7	Specific impact tests	34
Annex 1	Post Implementation Review (PIR) Plan	35
A	The context in which the FRC operates	36
B	FRC decision-making groups – current and proposed	37
C	The current powers of the FRC and its operating bodies	38

# 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 carries out the following functions:

- promotes high standards of corporate governance through the Corporate Governance 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.
- 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 has reviewed its role with Government and with its stakeholders and identified significant constraints on its effectiveness. The Government and the FRC are seeking views on a set of proposals designed to address these constraints.

This consultation stage impact assessment invites views on the likely direct costs and benefits of the proposals. This assessment suggests that the proposals will reduce the costs associated with FRC regulation.

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.

Responses to the consultation, including this impact assessment are invited by 10 January 2012. Following consultation, the FRC will publish a feedback statement in response to stakeholders that have provided views and a process to produce a finalised impact assessment.

## Questions:

Q1: Do you have any general comments on this consultation stage impact assessment?

Q2: Do you have any comments on the assumptions and risks identified in relation to the proposals to reform the FRC?

Q3: Do you have any further information that could inform the costs and benefits of the proposals?

## 2. The case for change

### The FRC – An evolving organisation

The context in which the Financial Reporting Council (FRC) currently operates is summarised at Appendix A. The current and proposed structure of decision-making groups within the FRC<sup>1</sup> are summarised at Appendix B. The FRC's powers are summarised in Appendix C.

The FRC has evolved considerably in terms of its role and structure since it was established in 1990. In developing the proposals on which the Government and FRC are now consulting, the FRC has drawn on its extensive experience of regulatory and organisational change and its close links with its stakeholders.

The FRC 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:

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<sup>1</sup> See Annex C for comparison of current and proposed decision-making groups.

- 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.

As part of its expanded remit, the FRC was given responsibility for independent oversight of statutory audit as described in Company Law<sup>2</sup> and the EU Directive<sup>3</sup>.

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

<sup>2</sup> See Schedule ten 24 (1) (a): <http://www.legislation.gov.uk/ukpga/2006/46/contents>

<sup>3</sup> EU Directive on Statutory audit can be found here: [http://ec.europa.eu/internal\\_market/auditing/directives/index\\_en.htm](http://ec.europa.eu/internal_market/auditing/directives/index_en.htm)



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 £22m, which will be met through the funding arrangements agreed with stakeholders. This will be 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
- £2.6m under the actuarial funding arrangements, and
- £0.6m through a reduction in reserves.

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. But there are underlying reasons why it 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](http://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 government to investigate the role of equity markets in shaping UK businesses. The Department for Business Innovation and Skills

has also recently consulted on the value of long termism to performance. 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 has 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. This could have a negative impact on the quality and volume of investment.
- 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. There is a risk that in aggregate regulation by its seven different bodies will be over-burdensome as the FRC Board does not have the necessary remit with regard to issues faced by the organisation in the round.

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 FRC has to refer cases of poor quality audit to a committee of the relevant professional body and seek its agreement before the FRC 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 FRC has two options to sanction: to remove recognition of accountancy professional bodies or to require, through application of the courts, to take action. The conduct of professional bodies, firms and individuals do not always warrant such heavy handed responses.

### **3. Options considered**

#### **Policy objective**

The overall objective is 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.

In developing the most effective response to the four constraints on its effectiveness, the Government and the FRC took into account the following criteria:

### ***Addressing market failure***

Good corporate governance and reporting are essential to the effective operation of a free capital market. The principal market failure that the FRC's work addresses is information asymmetry between companies and investors.

Full and accurate disclosure of information on companies' governance and performance enhances confidence in capital markets and helps foster investment. Lack of transparency in corporate performance can lead to misallocation of resources whereby investments do not receive appropriate returns. The FRC's regulatory interventions are designed to promote the disclosure of information that is of value to investors.

Addressing the constraints identified by the Government and the FRC will enable it to respond more effectively to this market failure.

### ***The rationale for Government intervention***

The FRC's effectiveness as a regulatory authority depends on an appropriate framework of statutory powers. The legislative changes to underpin the proposed reforms to the FRC are designed to enable it to contribute more effectively to its mission and address the market failure identified above.

### ***Building on strengths***

Important aspects of FRC regulation are not based on prescriptive regulatory requirements. The FRC's work on corporate governance is based on the UK Corporate Governance Code and the Stewardship Code which promotes the quality of engagement between investors and companies. The FRC has promoted good quality corporate reporting and auditing through initiatives to highlight key issues and risks as an alternative to formal regulatory requirements. And it has operated its arrangements for actuarial standards and regulation on a non-statutory basis with the support of the actuarial profession and the insurance and pension sectors. It is not intended that any reforms should compromise the effectiveness of these initiatives, or the FRC's commitment to working closely with the markets, including business, investors and the professions.

Similarly, it is not intended to change the basis on which the FRC is funded through contributions from those subject to FRC regulation on the basis of non-statutory arrangements.

### ***Avoiding additional regulatory processes***

The Government and the FRC have focused on options for change which do not involve additional regulatory costs and build as far as possible on the regulatory arrangements already in place.

## Legislative requirements

The options that have been considered are based as far as possible on those that would require secondary legislation.

Three broad policy options were identified on the basis of these criteria and are reviewed in this consultation stage impact assessment:

### **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 not excluding 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. 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 to the FRC Board rather than the FRC’s subsidiary bodies as at present will underpin reforms to the FRC’s governance and structure. These reforms will enable the FRC to 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<sup>4</sup>.

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, imposing proportionate sanctions when necessary.

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<sup>4</sup> See link for evidence: <http://www.pwc.com/qx/en/press-room/2011/major-global-accing-nets-support-announcement-of-coop-agreement.jhtml>

- **A more proportionate range of sanctions** – proportionate sanctions 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 settlement of disciplinary cases without recourse to a full disciplinary tribunal would enhance the effectiveness of the FRC’s disciplinary arrangements without compromising their procedural fairness.

The proposals are designed to reduce the overall costs to market participants and the FRC. The estimated savings total approximately £9.8 million over 10 years.

The preferred option is designed as a coherent set of improvements which meet the problems identified. It includes seven supporting proposals (all requiring secondary legislation - except for Proposal 1 and 4 which do not require any legislative change).

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 this 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.

There is also a benefit to market participants and the wider economy from reduced risk of corporate failure which reduces the overall risk and cost to the economy of crises. The FRC’s contributes to this through its activities and interventions in the market which contribute to a more stable economy by raising and enforcing standards of corporate governance and reporting where necessary. HMT’s consultation on the “A new approach to financial regulation” estimated the benefit of prudential regulation in averting future financial crises to be between £250m and £2,000m a year (or 0.02 per cent and 0.16 per cent of UK output per year using gross value added at basic prices and assuming UK output was £1,300 billion in 2010). If the FRC can, through its reform programme alone, contribute to prudential regulation by helping reduce the impact of financial crises by 1 percentage point, this would lead to benefits of between £2.5m and £20m per year.

**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 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. It would be likely to cost at least as much again as the current audit inspection arrangements, which are in the order of £2.5m a year. A scheme on these lines would be additional to the current arrangements operated by the accountancy professional bodies.

#### **Alternative options considered:**

Having concluded that Option 2 would bring no benefits and that the costs of Option 3 would significantly outweigh any benefits, the FRC also considered variations of Option 1.

However, these variations were not considered to be viable alternatives as there was not a strong rationale to exclude any individual proposal within the preferred option.

## **4. Option 1 – Streamlined structure/Reformed powers (preferred option)**

### **Summary assessment**

The Preferred Option (Option 1) has the following elements. 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 pages 18 to 31:

#### ***An investment focus for the FRC's regulatory activities***

The scope of the FRC's regulatory activities should be reviewed with the aim of enabling it to concentrate on those areas that are most important for the operation of the capital markets. Comments are invited on the scope for such narrowing and, in particular, on the following proposals:

- 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;

If this proposal is implemented there will be a modest saving of FRC and market participants' resources (£280k a year) devoted to monitoring audit quality for entities outside the proposed definition. (**Detailed Assessment 1 – Page 18**)

- 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.

This proposal would be neutral in terms of its costs to the FRC and market participants. The accountancy professional bodies fund all cases undertaken by the FRC. Any non-audit cases which the FRC no longer addressed would be dealt with by the professional bodies, which would continue to meet their costs. **(Detailed Assessment 2 – Page 20)**

The FRC's current role with regard to UK Generally Accepted Accounting Principles (UK GAAP) will not be affected by this proposal. This will mean that the FRC will continue to provide accounting standards for UK small companies and other entities and will continue to represent their interests at the international level. A number of public sector bodies are subject to IFRS – which the FRC will continue to influence in consultation with UK stakeholders.

The FRC recognises the economic importance of smaller companies. It has consulted extensively on the future of UK GAAP, including an outreach programme to raise awareness with small and medium sized enterprises.

### ***Streamlined governance and structure***

The FRC should remain well connected to and informed by market participants - but it needs to be more streamlined and efficient. It is therefore proposed that:

- statutory powers should be delegated direct to the FRC Board, and not to its individual operating bodies as at present, to enable the FRC to take decisions at the right level within a streamlined structure;
- the FRC should report annually to the Secretary of State and Parliament on the exercise of its powers and those delegated to it;
- in future the FRC Board should be supported by two Board Committees – one to focus on Codes and Standards, the other on Conduct. This arrangement will replace the existing seven operating bodies.

Taken together, these 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 3 – Page 21)**

### ***Reinforced independence***

The FRC's supervisory and disciplinary responsibilities should be operated independently of the accountancy professional bodies. In particular, it is proposed that the FRC should have:

- 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 4 – Page 24)**

- 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 (£40k a year) by simplifying the arrangements for securing improvements to the FRC's disciplinary arrangements. **(Detailed Assessment 5 – Page 26)**

### ***Proportionate regulation***

The FRC should have a range of proportionate sanctions and procedures. In particular, it is proposed that through the statutory framework and its agreed arrangements with the professional bodies:

- 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 6 – Page 28)**

- 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 should enhance the efficiency of the present disciplinary arrangements without reducing the effectiveness or fairness, and will reduce the costs borne by market participants (by an estimated £750k a year). **(Detailed Assessment 7 – Page 30)**

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

These inquiries will support FRC regulatory decisions without increasing its overall costs or the costs to market participants and it proposed to conduct them on the basis of the FRC's existing 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 it will consult further and will develop the necessary impact assessment.

The issue, assumptions, cost benefit and risks of each are outlined in this section. Overall, the overarching assumptions and total net monetised costs and benefits for this option are set out below. Table 1 below summarises the net monetised costs and benefits of each of the proposals.

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 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
<b>An investment focus for the FRC's regulatory activities</b>				
1	Narrowing the scope of audit inspection	0	<b>280 2,400</b>	
2	Narrowing the scope of disciplinary arrangements	0	0	0
<b>Streamlined governance and structure</b>				
3	Powers with the FRC Board; not the Operating Bodies	<b>-480 260</b>		<b>1,600</b>
<b>Independent supervisory and disciplinary arrangements</b>				
4	Powers to require professional bodies to impose sanctions for poor quality audit	0	<b>0 0</b>	
5	Powers to make rules which it can operate without being required to obtain the agreement of the professional bodies.	0	<b>40 340</b>	
<b>Proportionate sanctions</b>				
6	Powers to settle disciplinary cases without Public Hearing	0	<b>750 6,500</b>	
7	Powers to sanction professional bodies	0	<b>0 0</b>	
<b>Total</b>		<b>-480</b>	<b>1,330</b>	<b>10,840</b>

### **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 proposals are largely legal and administrative costs which are likely to be at comparable levels for both the FRC and market participants. This assumption will be refined in the light of the consultation.
- The time period chosen is 10 years. This is the standard period recommended by BIS guidance and is appropriate for these 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 in to statute 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.

## **Detailed Assessment 1 – An investment focus for the FRC’s activities – Narrowing the scope of audit inspection**

### **Issue**

As a general point, the consultation will seek to better understand the views of different stakeholders with regard to where the FRC should focus its activity and will lead to a clearer definition of its focus.

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.

Proposal: 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.

The FRC would make the primary focus of its activities approximately 4,000 companies under this option – see table 1 below.

Table 1: Number of entities covered by different categories of company ownership

<b>Market/size of entity</b>	<b>Number of entities</b>
FTSE 100	100
FTSE 250	250
Other main market	2,000
UK AIM/Plus Markets	1,000
Large private companies	600
<b>Total</b>	<b>3,950</b>

(Source Audit Inspection Unit)

## Market Research

Listed companies are significant economic entities. At the London Stock Exchange<sup>5</sup>, combined market capitalisation was £3.7 trillion in 2010 or 112% of UK GDP in that year<sup>6</sup>.

Large private companies make up a significant proportion of the economy. The turnover of the 100 largest private companies was in excess of £160 billion in 2010<sup>7</sup>.

## Assumptions

The practical impact of the proposal would be that the FRC would narrow the scope of its audit inspections. 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<sup>8</sup>.

## Costs and Benefits

To illustrate the impact of this proposal, if the policy had been in place in 2011/12, out of the 1,475 audits of the largest ten audit firms (see below) which fall in scope of FRC investigations, 255 (17%) would not have been within the FRC's primary focus<sup>9</sup>.

**Benefits:** The benefits (non-monetised) result from a sharper and clearer focus on the FRC's mission. The quality of audit in relation to those entities no longer in scope would continue to be a matter for the recognised supervisory bodies under their existing arrangements.

**Savings:** The AIU reviews the quality of the statutory audits of listed and other major public interest entities that fall within its scope, as determined each year by the Oversight Board, and of the firms' policies and procedures supporting audit quality<sup>10</sup>.

Firms which audit more than ten entities within the AIU's scope are subject to full scope AIU inspections covering both the review of policies and procedures supporting audit quality and the review of a sample of individual audits. There are currently ten such firms ("the major firms") as follows:

Baker Tilly UK Audit LLP	Mazars LLP
Grant Thornton UK LLP	Deloitte LLP
BDO LLP	PKF (UK) LLP
KPMG LLP and KPMG Audit PLC	Ernst & Young LLP
Crowe Clark Whitehill LLP	PricewaterhouseCoopers LLP

<sup>5</sup> London Stock Exchange: A guide to listing on the London Stock Exchange, the London Stock Exchange, (2010)

<sup>6</sup> ONS data and FRC calculations. UK GDP are at 2006 basic prices and can be found at: [http://www.statistics.gov.uk/downloads/theme\\_economy/Real-time-GDP-database.xls](http://www.statistics.gov.uk/downloads/theme_economy/Real-time-GDP-database.xls)

<sup>7</sup> Fast Track research: <http://www.fasttrack.co.uk/fasttrack/downloads/2010toptrack100.pdf>

<sup>8</sup> Large private companies are defined in this IA as those with annual turnover above £500m.

<sup>9</sup> *ibid*

<sup>10</sup> The Companies Act 2006, as amended, requires the independent inspection of auditors undertaking statutory audits of listed companies and other entities in whose financial condition there is considered to be major public interest. This latter category is determined from time to time by the Oversight Board.

If the scope of the AIU's inspection programme was aligned with the proposed primary focus of FRC regulatory activity, publicly traded and large private companies, there would be two modest cost savings:

- One firm out of the ten "major firms" would drop out of scope. The FRC estimate a resulting cost saving of approximately £90k (280 hours at £45 per hour for 7 staff) per annum. This is the approximate cost of each full file review which involves visiting the company and conducting an in-depth investigation.
- There would be an additional cost saving of approximately £50k (£15.8k x three cases) by not undertaking inspections in relation to smaller audit firms (outside the largest ten) – which the AIU has previously chosen to undertake as part of its annual programme. These smaller firms are usually investigated on a file review basis, which is significantly less labour intensive. In 2010/11, the FRC conducted around 41 file reviews of firms outside of the FTSE 350.

The average cost of a case file review to audit firms is approximately £16k – this is based on the FRC's understanding of the nature of the process of investigations and its own experience. The FRC would reduce the number of case file reviews by around 3. The total saving for the FRC is £140k (£90k + £50k). These cost savings would be duplicated by the market as firms that fall out of scope would no longer have to devote resource to file reviews. The total saving to the economy is therefore £280k (£140k + £140k).

## **Risk**

The key 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. However, the recognised supervisory bodies are themselves subject to FRC oversight. The consultation process will inform the FRC's decision on scope: in particular on the extent to which any concerns that result from a decision to narrow the scope following the consultation materialise in practice.

Smaller companies are not covered by the present AIU arrangements: this proposal would not, therefore, affect them.

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

### **Issue**

The vast majority of accountants in the UK and Ireland choose to train and qualify under the auspices of one of the accountancy bodies and subscribe to be a member of such a body. Members and Member Firms of the accountancy bodies in the UK are subject to the rules and regulations of the body of which they are a member. Each accountancy body operates its own disciplinary arrangements to deal with complaints of unsatisfactory conduct by their Members. They are primarily responsible for investigating and disciplining their Members and, where appropriate, Member Firms. However, separate disciplinary arrangements exist for those cases which are considered to be a matter of public interest. Public interest cases are dealt with by the AADB, which operates independently of the accountancy bodies.

Proposal: 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.

### **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 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 non-audit cases 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 that it will clarify the FRC's role as primarily focussed on the efficiency of the capital markets, underpinned by the quality of audit.

### **Risk**

A potential risk is that the narrowing of the scope of the cases that the FRC undertakes will adversely impact on confidence in standards of behaviour in areas outside audit. The FRC will consider carefully the responses to this proposal in that light.

## **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 C. It is proposed that in future 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. 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.

Informal soundings of FRC stakeholders suggests that this approach would be a welcome simplification of the FRC's structure.

Proposal: The preferred option minimises duplication of activity and resource and helps the FRC move to a more optimal structure in terms of efficiency and coverage of the two main areas

of FRC activity: Codes and Standards and Conduct. The seven operating bodies are reduced to two Committees<sup>11</sup>:

- 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.

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 cost of FRC reform project is estimated to be a one-off cost of **£480k** (see Table 3 below). This is a reasonable cost estimate based on FRC experience of organisational change over a number of years, including establishing the arrangements for actuarial standards and regulation in 2005/06 and setting up the AADB disciplinary scheme as a proxy for the cost of setting up the new sanctioning regime which is also a transitional cost – see Proposal 2.

The IT and external support costs are also based on previous experience. These estimates are for external advice and the cost of redesigning the FRC website to reflect the new structure. The new website will make it easier for new and old visitors to understand the work of the FRC.

The FRC Plan & Budget 2011/12 explained the FRC's intention to accommodate these 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. The Plan allows for a reduction of £0.5m in reserves to meet the costs of the reform proposals.

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<sup>11</sup> See Annex C for a comparison of the current and new structure.

Tables 2 & 3: Cost establishing actuarial standards and regulation (ASR) and Estimated cost of streamlining the FRC structure

	<b>Table 2 Costs of establishing ASR 2005/06</b>	<b>Actual £k</b>
1.	Recruitment	162
2.	Legal	6
3.	Support Services	26
4.	Staff costs for 'set-up' (early running costs)	117
	<b>Total 311</b>	

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

(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 £480k 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 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 wages 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 **£80k** 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, **£260k (£180k + £80k)**.

The sensitivity analysis in Table 4 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 is inclusive of the £80k administrative savings only as the FRC is confident of achieving the £180k fee based saving. 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.

Table 4: sensitivity analysis

<b>Scenario</b>	<b>No. of Board meetings saved</b>	<b>Estimated savings</b>
Low	10	£40k
Best	20	£80k
High	30	£120k

The monetised benefits identified as savings will accrue to the FRC and in due course the FRC's funding groups. The non-monetised benefits which include enhanced transparency and therefore accountability of the FRC will benefit market participants (investors, auditors and listed and non-listed companies) via a more effective regulatory framework.

## **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.

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.

There is also a risk that the new structure proves more costly than expected to implement and manage. Careful planning and budgetary control will address this risk.

## **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.”<sup>12</sup>

This proposal will essentially 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 has to negotiate with the supervisory bodies when it feels there is a need for them to take action. This can cause delay and compromise the effectiveness of the disciplinary framework.

## **Market analysis**

Audit represents a significant cost to UK business – estimated at £2.1 billion<sup>13</sup>. 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<sup>14</sup>.

Proposal: To enable the FRC, through its statutory powers and 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.

This proposal would allow the FRC the ability to utilise the same range of proportionate sanctions on audit firms and individuals as the professional bodies, enhancing the independent oversight of the professional bodies. 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 license, the suspension of a firm or individual’s audit license 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 was reached fairly and could withstand legal challenge.

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 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 additional cost will be involved in operating with this enhanced degree of independence from the supervisory bodies. The FRC currently operates the monitoring arrangements on which the proposed sanctions would be based and the sanctioning

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<sup>12</sup> See <http://www.pwc.com/gx/en/press-room/2011/major-global-accing-nets-support-announcement-of-coop-agreement.jhtml>

<sup>13</sup> See link for source: Cost-effectiveness of FRC regulation: [http://www.frc.org.uk/about/cost\\_effective.cfm](http://www.frc.org.uk/about/cost_effective.cfm)

<sup>14</sup> See the AIU Annual Report: <http://www.frc.org.uk/images/uploaded/documents/AIU%20Annual%20Report%202010-11.pdf>

would be undertaken by the supervisory bodies under the arrangements which they currently operate.

### **Costs and benefits**

Costs: The FRC does not expect there to be any significant transitional costs associated with this proposal. The sanctioning regime would be an internal one, with decisions taken at either Conduct Committee or Sub-committee level.

The FRC does not expect there to be any significant use of these sanctions in addition to what would have been issued otherwise. The FRC already works closely with the professional bodies in agreeing sanctions. However, this proposal would send a strong signal to the market that the disciplinary arrangements are under appropriate independent oversight.

Benefits: The key non-monetised benefit is 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.

### **Market Research**

Financial Services Authority research<sup>15</sup> 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.

### **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.

## **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.

Proposal: 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

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<sup>15</sup> Financial Services Bill - Impact Assessment of additional powers for FSA to suspend and fine certain persons

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 simplify the consultation arrangements.

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 £200k for the FRC and £200k for the market participants. Costs are based on the experience of the 2008/09 review.

Table 5 – FRC external legal fees associated with scheme reviews

Year	2008-09	2009-10	2010-11	2011-12	Total
	(£k)	(£k)	(£k)	(£k)	(£k)
Scheme review	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<sup>16</sup> 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.

<sup>16</sup> See link for consultation document: The AADB Accountancy Scheme Review  
<http://www.frc.org.uk/documents/pagemanager/aadb/Accountancy%20Scheme%20Review.pdf>

The FRC assumes that it will save 50%<sup>17</sup> of the costs of a review by speeding up the process through this proposal. Given an assumed cost of £200k per review on the present basis, the total saving would, therefore, be £200k over 10 years which is £20k per annum (£200 X 2 / 10). This is doubled to reflect the savings that would be achieved for market participants, which equates to **£40k** 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 appropriate consultations with the professional bodies, market participants and other stakeholders prior to taking decisions about any changes to its disciplinary rules and procedures.

## **Detailed Assessment 6 - Powers for early settlement of disciplinary cases**

### **Issue**

Public confidence in the effectiveness of the disciplinary arrangements could be enhanced by swifter conclusions to cases.

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.

Proposal: To enable the FRC to take a more proportionate approach to cases, where it may be reasonable to seek settlement 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.

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<sup>17</sup> 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.

## Costs and Benefits

Costs: The FRC does not expect there to be any additional costs as a result of gaining powers to agree settlements 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 from not going to tribunal

There is a possibility that cases may be settled without going to a tribunal. The FRC estimates that it 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**.

### A more rapid conclusion to cases going to tribunal

The proposed powers would also speed the tribunal process itself, with significant associated reductions in costs to the FRC and market participants. This would result from the ability to reach agreement on an outcome at the start of the tribunal process, including agreement on appropriate sanctions, rather than pursuing a tribunal through all its stages before an acceptable outcome is secured.

Taking account of the scope for reducing the number of tribunals, the FRC estimates that in any given year there could still be 3 tribunals that could be brought to a conclusion more speedily – saving £50k in each case. The total saving would be £150k. Market participants are assumed to make a similar saving, resulting in a total saving of **£300k**.

Total estimated savings from avoiding tribunals and reducing the length of tribunals are, therefore, **£750k (£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.

## **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.

Proposal: 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.
- Attach conditions to the continued recognition of a recognised supervisory or qualifying body.
- 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. The consultation stage will be used to refine the details of what the sanctions will be, for example a range of fines.

An enforcement order might for example require a professional body to carry out a specified number of monitoring visits to audit firms within a given period, or to carry out an external moderation of the quality of its examinations by a specified date.

Examples of recognition conditions might be 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; or 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 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 also be able save time in its negotiations with professional bodies with regard to disciplinary matters involving them. The professional bodies will also save an equal amount of time. The amount of time saved will depend on the specific problem.

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<sup>18</sup>, 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.

## **Risk**

There is a risk that the supervisory and qualifying bodies do not respond to the creation of the more proportionate range of sanctions and that the FRC continues to rely on the "nuclear options". Given the constructive relationship between the FRC and the supervisory and qualifying bodies, this is not considered a likely outcome.

## **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.

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<sup>18</sup> See link for source: Cost-effectiveness of FRC regulation: [http://www.frc.org.uk/about/cost\\_effective.cfm](http://www.frc.org.uk/about/cost_effective.cfm)

## **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 consultation stage impact assessment has identified in its preferred option, 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 Board have considered this option and were unanimous in their view that the costs of operating a licensing regime, both for the FRC and for the market, would be prohibitive. The proposals of this option are:

### **Investment focus for the FRC's regulatory activities**

- **Proposal 1** –The FRC's scope and targeting should be more closely aligned with its core mission.

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.

### **Streamlined governance and structure**

- **Proposal 2** – 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**

- **Proposal 3** – Powers to operate licensing regime

FRC operates a licensing arrangement: 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.

This option would effectively replicate the activity of the professional bodies in respect of public interest entities<sup>19</sup>.

## 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. Based on PCAOB costs, the cost of operating the UK licensing regime could be approximately **£1.9m** per year (**76 x £25k**)<sup>20</sup>.

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<sup>19</sup> Public interest entities would be defined by Proposal 1.

<sup>20</sup> see PCAOB Annual Report <http://pcaobus.org/Pages/default.aspx>

The total cost 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<sup>21</sup>. 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. However, the cost of operating a licensing arrangement alone is sufficiently prohibitive to discount this option.

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.

## 7. Specific Impact tests

The reform proposals of the FRC do not have an 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

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.

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<sup>21</sup> *ibid*

# Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

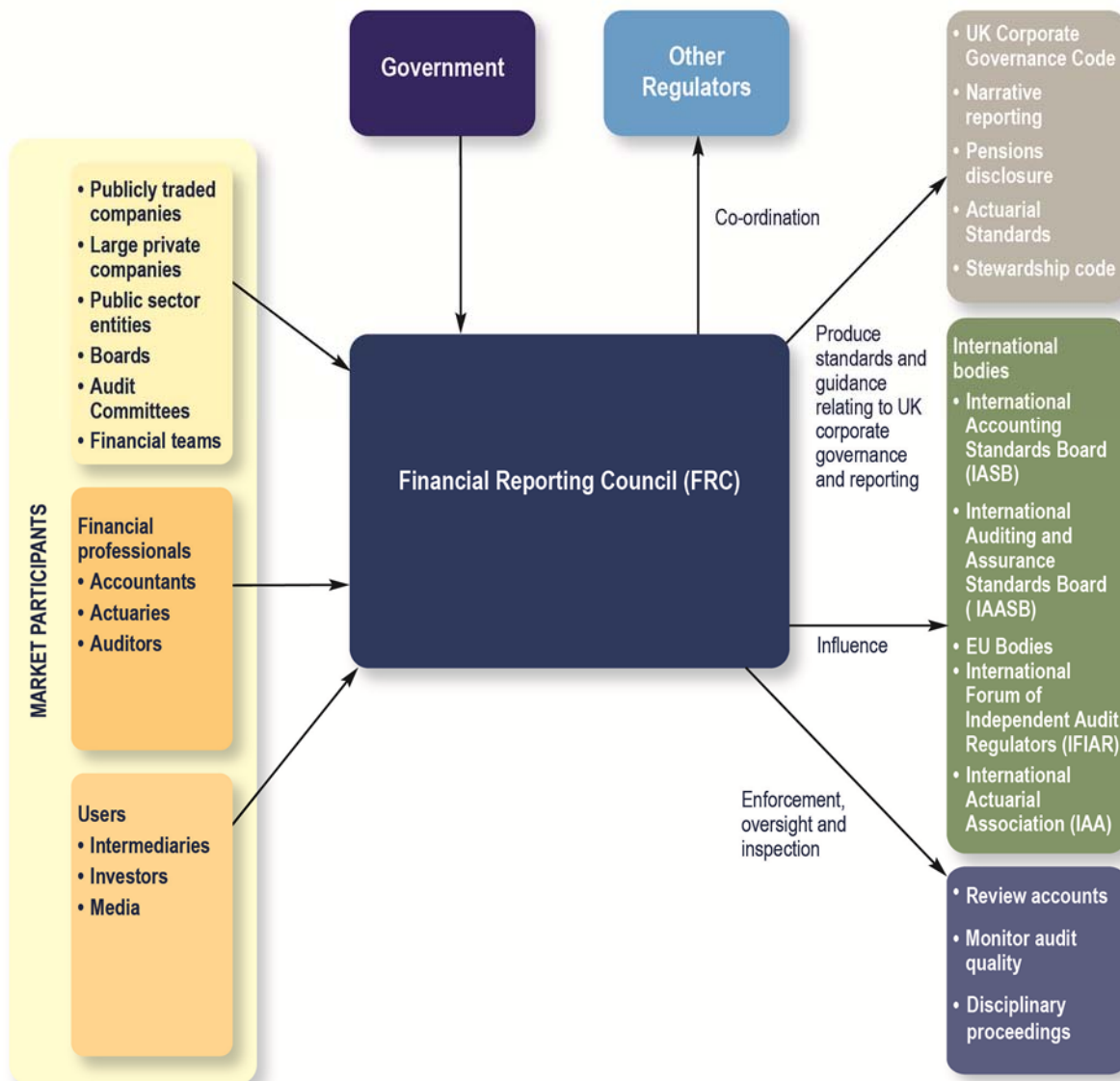
## Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p><b>Basis of the review:</b> [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review, or there could be a political commitment to review (PIR)];</p> <p>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 the market.</p>
<p><b>Review objective:</b> [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p> <p>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 the market.</p>
<p><b>Review approach and rationale:</b> [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p> <p>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.</p>
<p><b>Baseline:</b> [The current (baseline) position against which the change introduced by the legislation can be measured]</p> <p>The baseline will be the costs and benefits associated with the present arrangements. The response to the consultation stage impact assessment will inform the baseline for the Review.</p>
<p><b>Success criteria:</b> [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p> <p>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.</p>
<p><b>Monitoring information arrangements:</b> [Provide further details of the planned/existing arrangements in place that will allow a systematic collection of monitoring information for future policy review]</p> <p>The FRC's current arrangements for monitoring the quality of corporate reporting and auditing will form the immediate basis for collecting the necessary data.</p>
<p><b>Reasons for not planning a review:</b> [If there is no plan to do a PIR please provide reasons here]</p>

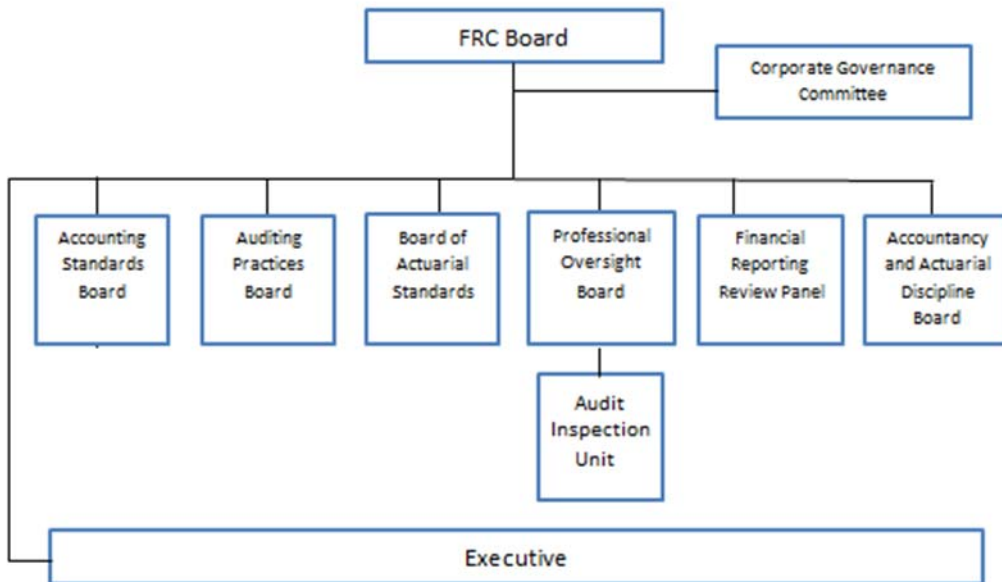
## Appendix A – The wider context for the FRC’s work

### The context for the FRC’s work

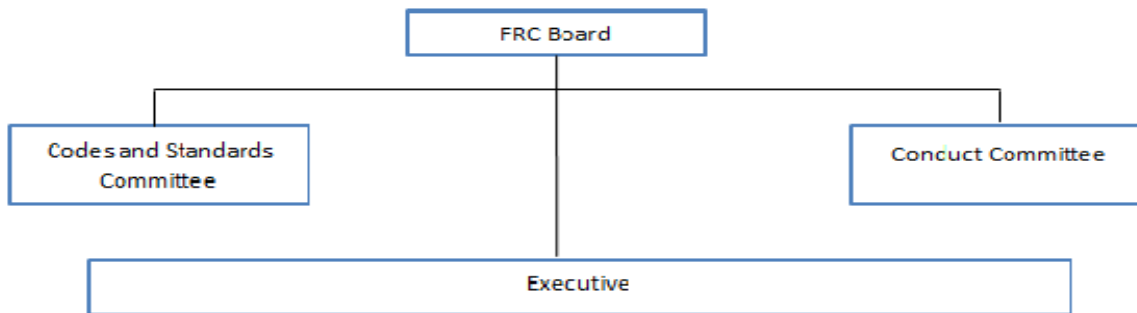


## Appendix B – Organisational structure of the FRC’s decision-making groups

### Existing Structure



### Proposed structure



## Appendix C – 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	AIU of POB	The arrangements for independent monitoring provided by the AIU amount to “appropriate

significant entities.		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 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 set 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 to members of the actuarial profession which raise or	AADB	The bye laws of the actuarial professional bodies provide that their members are subject to the AADB actuarial scheme. These provisions are supported by the Memorandum of Understanding between the FRC and the

appear to raise important issues affecting the public interest.		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."

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