Financial Reporting Council

Annual Report and Accounts 2013/14

ANNUAL REPORT AND ACCOUNTS OF THE FINANCIAL REPORTING COUNCIL

INCLUDING THE REPORT OF THE INDEPENDENT SUPERVISOR

YEAR TO 31 MARCH 2014

The Report of the FRC as the body designated by a delegation order under section 1252 of the Companies Act 2006 and the Report of the Independent Supervisor is presented to Parliament pursuant to sections 1231(3) and 1252(10) of, and paragraph 10(3) of Schedule 13 to, the Companies Act 2006.

The Report of the Independent Supervisor is also presented, pursuant to section 1231(2), to:

- The First Minister in Scotland;
- The First Minister and Deputy First Minister in Northern Ireland; and,
- The First Minister for Wales and is laid before the National Assembly for Wales pursuant to section 1231(3A) of the Companies Act 2006.

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This document is also available at our website at www.frc.org.uk

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Our Mission

To promote high quality corporate governance and reporting to foster investment

Our Values

We work in the public interest, seeking at all times:

- to be **joined up** to make the most of the breadth of our role
- to **reach out** to our stakeholders to secure their expertise to be **evidence based** to ensure our decisions are correct and respected
- to be **decisive** to ensure problems are addressed in a timely manner
- to **show respect** to others; recognising the value in different perspectives

The FRC at a glance

SUPPORTING STRATEGY TRUSTWORTHY INFORMATION

PROMOTING HIGH QUALITY CORPORATE GOVERNANCE AND REPORTING TO FOSTER INVESTMENT

SUPPORTING STRATEGY TRUSTWORTHY BEHAVIOUR

- Set UK Corporate Governance and Stewardship Codes
- Set UK standards and influence international standards for corporate reporting, audit and assurance, and actuarial information
- Provide a Financial Reporting Lab to bring together investors and preparers

- Monitor the quality of accounts published by publicly traded and large private companies
- Monitor and report publicly on the quality of the audit of listed and other major public interest entities
- Set ethical standards for auditors
- Oversee the regulatory activities of the accountancy and actuarial professional bodies
- Provide independent disciplinary arrangements for public interest cases

Chairman's Statement

This is my first year-end statement as Chairman of the FRC. The progress the organisation has made during the year reflects the leadership of my predecessor, Baroness Hogg. Under her guidance, the FRC has focused its authority and resources on the contribution that high quality corporate governance and reporting can make to the effective functioning of the capital markets and to economic stability and growth.

This is the first FRC Annual Report to be based on the new framework for the Strategic Report. The Report explains how the FRC seeks to act in support of the wider public interest. The Report also, importantly, forms part of our accountability to Parliament and to our wide range of stakeholders, including of course those who fund our work. It explains our regulatory approach - our business model - and gives an account of the way in which we have used the powers delegated to us by Parliament. The Report also includes the first financial statements we have prepared in accordance with the new UK Generally Accepted Accounting Principles (UKGAAP).

The FRC pursues outcomes - trustworthy behaviour and information - which are easier to recognise in practice than to define in theory. Trust is not achieved through compliance as an end in itself but through a belief on the part of companies, investors, auditors, actuaries and the wider professional community that there is a strong public interest in sound governance, active stewardship, and fair, balanced and understandable reporting.

We also seek to exercise thought leadership in defining and debating the way in which boards and investors can most effectively apply high standards of governance and reporting. We believe that boards should be more diverse with, as one example, more women contributing at board level; and that reports should be clearer and more concise. I have championed the FRC's approach to these issues in my former roles. Consequently, I will reinforce the organisation's continuing challenge to the corporate and investor communities to think creatively and constructively to build on the UK's reputation for good practice in corporate governance and reporting.

Baroness Hogg has created and chaired a strong FRC Board. I should like to welcome Gay Huey Evans as our newly-appointed Deputy Chairman after 18 months of service on our Board and I wish to pay tribute to her predecessor, Glen Moreno, who brought insight, experience and constructive challenge to our work. Peter Chambers, Richard Fleck and Sir Steve Robson stood down from the Board. We will miss their contributions to our work. We were pleased to welcome Sir Brian Bender, David Childs and John Stewart, who will bring fresh insight and considerable experience of the UK commercial and regulatory environment.

The FRC is supported in its work by top-class people, whose skills and energy enhance our governance, including those who serve on our Conduct and Codes & Standards Committees, sub-committees and Councils. I am grateful to the FRC's Chief Executive Officer, Stephen Haddrill, and the FRC's strong executive team for their continuing support and commitment; and I look forward to working with them in the years ahead on the vital task of promoting high quality UK corporate governance and reporting.

Sir Winfried Bischoff

Chairman

9 July 2014

Chief Executive's Overview

This Strategic Report is designed to help our stakeholders evaluate our performance in 2013/14 and our future plans. We have aimed to give a balanced view of our achievements and challenges. Our full Annual Report also covers our governance and financial statements, our disclosures on principal risks and our oversight of the accounting and actuarial professions.

Achievements and challenges

The range of our responsibilities is wide. Regulators in most other countries do not combine standard setting with conduct supervision and rarely cover governance in addition to accounting and auditing. We work with boards, the professions and investors to promote high quality governance and effective investor stewardship, set standards for accounting, audit and actuarial information, monitor the quality of corporate reports and auditing, and oversee the accountancy and actuarial professions. We engage extensively with EU and international organisations.

Our wide role enables us to take a strategic view of governance and reporting. We use our regulatory tools proportionately and target our activities on the most significant risks. We believe strongly in principles-based regulation, exemplified in the 'comply or explain' approach that underpins the UK Corporate Governance Code. We value the role of UK accountants and actuaries and their professional bodies in supporting high standards in the public interest and work closely with them to maintain and enhance the UK's reputation as a thought leader in corporate governance and reporting.

We made progress in key areas during 2013/14:

- Companies are responding to our strategy, based on a coherent and robust framework of codes and standards, to promote 'fair, balanced and understandable' corporate reports including more informative audit committee and auditor reporting. There are encouraging signs that the introduction of the Strategic Report is providing investors with better and clearer insights into the way a business is run and its strategic direction.

- A key element of our strategy is to enhance audit quality and the relevance of audit to investors. We believe we are making progress in making audit more integral to corporate governance - in the context of enhanced board governance of risk management and enhanced corporate reporting outside financial statements. We are also seeing a positive response to the steps we have taken to promote audit re-tendering. In the coming year we will be assessing the cumulative effect of all these developments.

- We have seen further improvement in the level and quality of take-up of changes made to the UK Corporate Governance Code in 2012. We consulted on how the Code covers remuneration following legislative changes on remuneration policy and reporting.

- The new EU Audit Regulation and Directive reflects a great deal of work by the FRC and other UK stakeholders to ensure that UK audit regulation can remain effective and proportionate. We were particularly pleased that the experience of audit tendering in the UK helped to demonstrate that the original Commission proposal for rotation of audit firms every six years was disproportionate.

- We have continued to promote audit quality through our inspections and reported publicly on our findings overall and on the individual major audit firms. We also supplemented our programme of audit inspections with thematic reviews.

- We closed four long-standing and complex corporate reporting review cases during the year, each of which had involved Financial Reporting Review Panel Groups. We welcomed the response of a number of companies, including some within the FTSE 350, who voluntarily amended or corrected their reporting, citing our announcements as the catalyst for change.

- Our simplified financial reporting standards have been well received by UK companies. Following the new UK GAAP Financial Reporting Standards we issued in 2012/13, we updated the Financial Reporting Standard for Smaller Entities (FRSSE). We published new accounting and reporting requirements for entities with insurance contracts, simplified accounting for micro-entities, and amendments to accounting for debt instruments and hedge accounting.

- We increased the pace and effectiveness of our independent disciplinary arrangements for public interest cases involving accountants and actuaries.

- We established a Joint Forum on Actuarial Regulation with the Institute and Faculty of Actuaries (IFoA), the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Pensions Regulator (tPR). Member organisations are sharing information and coordinating their responses to public interest actuarial risks.

- We maintained our input to EU and international discussions that significantly influence the regulatory framework for UK governance and reporting. One of our Board members was appointed to the International Accounting Standards Board standards-setters advisory forum. A member of the FRC executive has held a seat on the International Auditing and Assurance Standards Board (IAASB) for many years; following his retirement we are pleased that another FRC colleague has been appointed.

There are also areas where we have not made the progress we would have wished during the year and which we will need to address in 2014/15:

- We are concerned that the pace of improvements in the quality of auditing of banks and building societies has not been sufficient. We are now carrying out a thematic review to identify root causes and raise standards.

- We have not yet implemented Lord Sharman's recommendations on going concern reporting. We are re-consulting on key elements of our proposed merged guidance on risk and going concern. Previous proposals were not regarded as proportionate.

- Corporate reports are not yet sufficiently clear and concise: we will be giving renewed focus to our efforts in 2014/15.

- We have identified the need for improvements in the quality of reporting by smaller listed and AIM quoted companies; and have set in hand a programme of work to understand the root causes and promote the necessary improvements.

- Our responsibilities in relation to third country auditors continue to pose a challenge in terms of our ability to secure the information we need.

- There is a great deal more to be done to promote principles-based regulation and effective co-operation between regulators across jurisdictions – and to focus attention on investor needs. Looking ahead we see a need to give more attention to influencing international prudential regulators in financial services, particularly as they grapple with the tension between transparent reporting by banks and the risks that poses to market stability.

Finally, although we benefited significantly from the reforms to our powers and structure in 2012 there are certain areas where we should like our powers to be strengthened. We are pleased to note that the new EU Audit Regulation provides for powers to secure information from companies in disciplinary cases. Although companies often assist us already, there can be delay as we convince them of the importance of doing so. We are also exploring with the Department for Business Innovation and Skills (BIS) the current limitations in what we can say about lessons learnt when there have been faults in reporting and auditing but the faults do not amount to misconduct and so will not be aired in a public tribunal.

Organisational overview

We have 134 staff and our expenditure in 2013/14 was £26m. We are relatively small and will remain a focussed organisation.

In assessing our overall performance we believe that the most important indicators are the extent to which we can demonstrate that we are making effective use of our regulatory activities to support high standards of corporate governance and reporting in the UK and influence EU and international developments – the themes of this Strategic Report. We are, during 2014/15, developing a set of indicators of our effectiveness in each main area of our work.

In addition, it is right that stakeholders should be able to assess the progress we have made in delivering the projects and activities in our Three Year Strategy 2013/16 and our annual business plans. We report on the delivery of the most significant elements of our Plan for 2013/16 in this Strategic Report and publish separate reports on the delivery of the statutory functions which underpin our role as the UK's independent regulator for corporate governance and reporting.

Overall we have a strong team of people with a range of professional skills and experience in setting codes and standards and delivering our monitoring and enforcement activities – some involving major financial and other institutions. We place great emphasis on developing our staff.

But we can only be truly effective as an organisation if we engage closely and effectively with the investment community, with directors and with those we regulate. Our stakeholders continue to provide us with thoughtful views on what we are trying to achieve, extensive information about the impact of existing regulation and potential changes and - in so many areas - their individual time and effort to help us get things right. We are profoundly grateful for their contribution.

Stephen Haddrill

Chief Executive Officer

Delivering our mission

Our regulatory approach

To contribute to our mission we have developed a regulatory approach (our 'business model') designed to focus our powers and resources on the areas where we can most effectively promote high standards and where necessary take action to enforce them. 'The FRC and its Regulatory Approach', https://www.frc.org.uk/regulatoryapproach, explains our role and our approach to our regulatory responsibilities which is based on strategies designed to support:

- trustworthy behaviour by directors and professionals and engagement with them by investors, and
- trustworthy information that contributes to informed decisions.

In addition, we seek to build justified confidence internationally in the UK regulatory framework for corporate governance and reporting, including across the EU and other major capital markets.

The UK Corporate Governance Code is based on the underlying principles of good governance including the exercise of judgement: accountability, transparency, probity and a focus on the sustainable success of an entity over the long term. It includes a clear principle that boards should provide annual reports and other information that is trustworthy and so present a fair, balanced and understandable assessment of the company's position and prospects.

The Stewardship Code sets out the principles of effective stewardship by institutional investors which help build confidence in the system and give force to the 'comply or explain' system on which the UK Corporate Governance Code is based as well as increasing accountability to clients and beneficiaries.

We promote the provision of trustworthy information through setting UK standards for accounting, audit and technical actuarial work and providing guidance on narrative reporting, contributing to high quality international standards and through the work of the Financial Reporting Lab.

We promote trustworthy behaviour by preparers, auditors and accountancy and actuarial professionals through our role in:

- monitoring the quality of reports and accounts published by public and large private companies in line with the legal framework including accounting standards and the overriding requirement to give a true and fair view. We make clear our expectations of how companies and other entities should approach financial reporting and regularly highlight the matters we regard as particularly important.

- monitoring and reporting publicly on the quality of the audits of listed and other major public interest entities and the policies and procedures supporting audit quality at the major audit firms in the UK. We highlight key messages on audit quality for audit firms and audit committees and determine proportionate sanctions where necessary.

- the oversight of the regulatory activities of the accountancy and actuarial professional bodies and through our own independent disciplinary arrangements for public interest cases involving accountants and actuaries, as well as by cooperating with other bodies – such as the PRA, the FCA and the tPR – which have an interest in the professionalism of their work.

A principles-based approach

We believe that we should be alert to developments in the markets but should only intervene when there is a demonstrable risk to address. The need for intervention must be based on careful analysis. When we do intervene, we should encourage and enable directors and those in the professions to exercise good judgement in response to circumstances rather than prescribing a detailed rule book. And in all our policy making and regulatory decisions we should protect our independence. We face the risk that our principles-based approach does not command respect in the wake of the financial crisis and public expectations of tighter rules. Our view is, however, that rules are easily circumvented and that our mission is better delivered through the adoption of a culture in business and the professions that embodies sound ethical and technical principles, good judgement and puts the public interest first.

The values of our organisation support this approach. We seek to be joined up to make the most of the breadth of our role; to reach out to our stakeholders to secure their expertise and reinforce our own capabilities; to be evidence based; to ensure our decisions are correct and respected; to be decisive to ensure problems do not go unsolved; and to be respectful of others, recognising the value in different perspectives. These values are promoted internally and staff performance is assessed against them as well as against the delivery of business objectives.

During 2014/15 we will review our regulatory approach against the Regulators' Code that the Government introduced in April 2014. We believe that we currently follow the principles of good regulation incorporated in the Code; and will make any necessary changes to ensure that we can demonstrate that we comply with its requirements, subject to the statutory framework within which we operate.

Our Three Year Strategy 2013/16

In 2013 we set out a three year strategy, based on our regulatory approach, which is to promote:

- High quality **corporate governance** and **investor stewardship** which foster trust in the way companies are run.
- High quality **corporate reporting** that is fair, balanced and understandable.
- **High quality audit** and **confidence in the value of audit.**
- **Actuarial oversight and standards** which underpin high quality actuarial practice, and the integrity, competence and transparency of the actuarial profession.
- Effective, proportionate and independent **investigative, monitoring and disciplinary procedures**.

For each area we also focus on our ability to **understand and influence** key developments. Our assessment of the current state of each area and our interventions are based on a range of evidence, including from our monitoring activities, in-house and independent research and consultations with stakeholders in relation to our annual plan and specific issues.

Corporate governance and investor stewardship

- The quality of governance amongst larger listed UK companies is generally sound. In December 2013, we published our annual review of the UK Corporate Governance and Stewardship Codes. The review showed evidence of early adoption of new reporting recommendations on the activities of the audit committee.
- Notwithstanding the high levels of compliance with the UK Corporate Governance Code, and that companies are getting better at describing their actual governance arrangements, many still struggle to articulate clearly why they have chosen not to comply with the Code. Additionally, investors need to aspire to the same level of transparency as they themselves expect of the companies in which they invest. Many statements on the Stewardship Code give limited insight into the investors' actual practices.
- The commitment by many fund managers and owners to engagement with companies is rising but there is considerable room for improvement. There were some encouraging signs that more engagement on a wider range of issues took place between large companies and their major shareholders. However, this was not the case across the listed sector as a whole and there were real concerns of an emerging 'engagement deficit' affecting mid-market companies. The FRC believes that a lack of direct contact with shareholders where there are significant issues to be discussed feeds the perception on the part of many companies that proxy advisers wield undue influence over voting outcomes. It is important for proxy advisers to explain to companies how they carry out their research and what they can expect in terms of communication; and for companies to hold advisers to account for the quality of their advice. The FRC supports the direction of travel of recent initiatives to address these issues.

- In general, we have concerns about whether companies, markets and policymakers take a sufficiently long-term view and we will be looking to provide thought leadership, particularly in the EU, on the developing role of risk capital.

Corporate reporting

- Generally, we found corporate reporting by UK companies to be good; though, overall, the quality of reporting by smaller listed and AIM quoted companies could be improved.

- We hold directors to account for their published reports and accounts. We expect all boards, when challenged, to respond to our requests for additional information and, in particular, to explain the basis for the assumptions underlying their key judgements. Boards were generally co-operative during the year, although we invoked our statutory power in order to receive responses from an overseas company. Companies who want their securities traded on the UK market are obliged to comply with a range of standards on governance, reporting and investor protection depending on the nature of their listing. For investors to have confidence in our market, all issuers are expected to comply with the relevant requirements.

- We were pleased to see clear and successful instances of companies having reviewed their annual report with a view to making it clearer and more concise. However, corporate reports generally have grown in length. Investors and companies increasingly express concern that the key messages about the company are buried in too much verbiage or are obscured by boiler plate. Our initiatives to promote Clear & Concise reporting seek to address this in line with the FRC's mission to improve the overall quality of corporate reporting in the UK and to ensure that information in annual reports is trustworthy and meets the needs of investors.

- As a first step the FRC has, following consultation, published Guidance on the Strategic Report - the new reporting required in companies' annual reports that gives investors an insight into the way the business is run and its strategic direction. The Guidance gives an overview of the various components of an annual report and considers where information can be placed both within and outside that document to help companies think innovatively about communication and improving accessibility of information. The Guidance also encourages companies to focus on the application of materiality to disclosures as a key step towards concise reporting.

- We have worked with European partners to stimulate debate on change to the IASB's Conceptual Framework through a series of publications and events – focusing on the needs of investors. We have highlighted the importance of stewardship, prudence, and reliability and made the case for the Framework to acknowledge that financial statements should provide an insight into the success of a company's business model.

Audit

- On the evidence from our risk-based inspection programme, the quality of auditing in the UK is generally good, most notably in relation to the very largest listed companies. But there is scope for improvement in the banking sector in particular, including a concern about the lack of sufficient challenge when testing key assumptions underpinning loan loss provisions. The 2013/14 inspection findings are set out in the Audit Quality Inspections Annual Report and individual firm inspection reports, which are published on the FRC website at https://www.frc.org.uk/AQRfirmspecificreports. We published for the first time a separate report on our work in relation to third country auditors and it is available on our web-site at https://www.frc.org.uk/Third-country-auditors. The report includes an explanation of the challenges in securing the necessary access and information.

- A 2013 survey commissioned by the FRC benchmarked the views of key audit stakeholders. The survey indicated that confidence in the value of audit correlated with the extent of day-to-day experience of audit: auditors and companies were generally confident in the value of audit. The largest proportion of stakeholders, and in particular many investors, called for more change including more transparency in auditor reporting and a more open and competitive appointment process to help improve their confidence in the independence of auditors in the transparency of the audit conclusions. Some of the concerns about independence and objectivity arose from the concentration of the market in the hands of a few firms. Informed by the survey and the FRC's own monitoring activity, the FRC set out a programme of measures designed to enhance audit quality and strengthen investor confidence. The survey will be repeated in future to test the effectiveness of the FRC's measures in meeting legitimate expectations.

- We report in some detail (in the Appendix to this Report) on our statutory oversight of the regulation of auditors by the recognised professional accountancy bodies. This meets our statutory obligation to report each year on this work to the Secretary of State. We see no reason at present to withdraw the recognition of any recognised body. That said, we have continuing concerns at the number of audit firms that receive an unsatisfactory grading for their audit work following an inspection by their body and there remains a need to find ways to improve audit quality within registered audit firms. And the bodies, in varying degrees, need to improve further the processes and practices for the approval of individuals able to take responsibility for an audit within a firm.

Actuarial oversight and standards

- Past evidence suggests that the level of confidence in the quality of actuarial work is high; this has been mostly supported by the findings of our recent post-implementation reviews of the impact of our standards in pensions and insurance. In 2013 the FRC undertook a review with the IFoA and other bodies to consider whether the framework for actuarial regulation remains appropriate and adequately addresses the risks of poor quality actuarial work. The outcome of the review forms our medium-term agenda. We will continue to set technical standards (including AS TM1 which we updated during the year), oversee the regulatory activities of the IFoA and operate a public interest disciplinary scheme. We have established a Joint Forum on Actuarial Regulation (JFAR) with the IFoA, the PRA, the FCA and tPR. The member organisations have agreed to work together within the context of their individual responsibilities to coordinate their responses to the public interest risks relating to actuaries and actuarial work.

- Our oversight of the IFoA's regulation of its members in the UK covers education, continuing professional development, practising certificates, ethical standards, monitoring and discipline. Our work this year has focused on the IFoA's progress in developing its proposed Quality Assurance Scheme for employers of actuaries (following the FRC recommendation in 2009), introducing a cross-practice standard for Actuarial Quality and Peer Review and a model international standard of actuarial practice (ISAP 1) produced by the International Actuarial Association, and developing an effective competence and standards regime for the actuarial function and other actuarial roles under Solvency II.

- Whilst we have been concerned with the speed of progress in previous years, we consider the IFoA is now making good progress with its Quality Assurance Scheme. Following a well-received consultation last year, the IFoA has published a working draft of its standard and commenced a pilot study with a small number of firms to test the proposed monitoring arrangements ahead of full implementation expected in 2015. We expect that, once finalised, the IFoA's new cross-practice Peer Review standard will, together with proposed changes to our technical actuarial standards, enable the FRC and IFoA to confirm that UK standards are substantially consistent with ISAP 1.

- Insurers are already making preparations for full implementation of Solvency II in January 2016. We recognise that the IFoA is now working with the PRA on the implications for the profession, and we welcome the IFoA's recent consultation on options for extending its existing practising certificate regime for life actuaries to cover the actuarial function in general insurance.

Our investigative and disciplinary procedures.

- We have made further progress in enhancing the effectiveness of our other conduct functions, including introducing the Auditor Regulatory Sanctions Procedure in November 2013. It is anticipated that the new Procedure will provide an important instrument for encouraging, and if necessary requiring, firms to improve the quality of audit work in the future.

- A particular feature of the year was the continuing progress in developing the FRC's independent disciplinary arrangements. The FRC has implemented changes to the Accountancy and Actuarial Disciplinary Schemes, provided sanctions guidance to Tribunals and enhanced the depth and breadth of the Professional Discipline team to provide a more effective and efficient disciplinary process; and published new disciplinary arrangements for accountants.

- During the last year we have ensured that disciplinary cases have a clear focus to enable those with responsibility, including the Case Management Committee, to make decisions on the progress of the cases. The team has significantly shortened the amount of time taken to investigate cases.

- A FRC Tribunal decision was issued in September 2013 in relation to Deloitte & Touche and the partner, Mr Maghsoud Einollahi, who were advisers to MG Rover Group. The Tribunal made findings of Misconduct in respect of all the allegations and imposed the following sanctions (in addition to costs): Deloitte & Touche: - a severe reprimand and a fine of £14 million; Mr Einollahi: exclusion from the profession for 3 years and a fine of £250,000. Deloitte & Touche and Mr Einollahi have been granted leave to appeal part of the Tribunal's decision and the sanctions have been suspended pending the outcome of that appeal.

- In December 2013, a Settlement Agreement was published between Executive Counsel and EY and a former partner, Mr Alan Flitcroft, following admissions of Misconduct by EY and Mr Flitcroft in relation to the audit of European Home Retail Plc and Farepak Food and Gifts Limited. This was the first case in which the new Settlement provisions in the amended Accountancy Scheme have been applied. The agreed sanctions and costs were as follows: EY: a reprimand and a fine of £750,000 (adjusted from £850,000 to reflect admissions made by EY in accordance with the Sanctions Guidance). Costs of £425,000; and Mr Flitcroft: a reprimand and a fine of £50,000 (adjusted from £60,000 to reflect admissions made by Mr Flitcroft in accordance with the Sanctions Guidance).

Our Plan for 2014/15

Our Plan for 2014/15 is based on our assessment of the current and prospective state of key aspects of corporate governance and reporting. Our Plan & Budget and Levies 2014/15 are at https://www.frc.org.uk/FRCplanandbudget.

Specific initiatives include:

- Identifying the root causes of difficulties smaller listed and AIM quoted companies have in meeting the requirements of reporting standards and encouraging improvement in the quality of reporting.

- A thematic review of UK bank audits to focus on aspects of how bank and building audits are conducted to identify why improving their quality has been slow and what needs to be done to achieve necessary improvements.

- Further guidance for audit committees - the guidance will address how audit quality and effectiveness might best be assessed by audit committees, with the objective of assisting effective implementation of the increased expectations of audit committees.

- Reviewing and updating the UK Ethical Standards for Auditors - with the objective of both implementing agreed measures and reviewing where further measures may be needed. For example, auditor independence requirements need to be reviewed in the light of increased rotation and other aspects of the EU Directive.

- Reviewing audit firm governance - The first review of the Audit Firm Governance Code will be carried out as planned and will be considered in the light of audit potentially becoming a less significant part of the firms' business models. FRC will look at proportionate methods of ensuring audit firms have the appropriate management structure and governance to effectively promote audit quality and to be assured of sufficient audit capacity to underpin UK corporate activity.

- Thematic inspections of certain audit areas, which are not typically a significant focus of individual engagement reviews.

- Extending our inspections of third country auditors. We expect to carry out five such inspections in 2014/15. We will also ensure that information is available for investors on the extent and scope of this work.

- Preparing for the implementation of the new oversight arrangements for local public sector audits in line with recent legislation. The first inspections under these arrangements will take place in 2016.

- Supporting application of the new UK GAAP to improve standards of reporting by non-listed entities. This work will cover the impact of the standards, clarifying policy intentions, overseeing Statements of Recommended Practice (SORPs) and keeping abreast of change to EU requirements. The accounting taxonomies for the new UK GAAP are being updated to enable companies to report in eXtensible Business Reporting Language (XBRL) format.

- Build on work with other regulators and the IFoA to promote the quality of actuarial work; undertake a substantive review of the framework of technical actuarial standards; and in conjunction with other regulators develop an actuarial risk map to support our standard setting.

- Engage with other regulators on the implications for FRC technical actuarial standards of the pension reforms announced in the March 2014 Budget Statement, including the role of AS TM1 in statutory pensions illustrations and the wider approach to defined contribution pension communication.

Developing indicators of our effectiveness

As part of our Plan for 2014/15 we are developing the following indicators:

Corporate Governance and stewardship:

- Evidence of an improvement in the level and quality of take-up of changes made to the UK Corporate Governance Code in 2012, mainly on the adoption of board diversity policies, having more meaningful reporting by audit committees and putting external audit out to tender.

- Evidence of improvement in the clarity of explanations given by FTSE 350 companies for selected UK Corporate Governance Code provisions.

- Evidence of the extent to which smaller listed companies adopt UK Corporate Governance Code recommendations on board and committee composition.

In relation to investor stewardship, we will draw on the stewardship surveys carried out by the Investment Management Association and the National Association of Pension Funds, including evidence of:

- The frequency and scope of reporting by asset managers to clients and levels of satisfaction with that reporting;

- The percentage of mandates awarded by asset owners to asset managers that explicitly refer to stewardship; and

- The percentage of Stewardship Code signatories with independent opinions on their engagement who make those opinions available to clients.

Corporate reporting

- The quality of reporting assessed through our Corporate Reporting Review programme.

- The extent of adoption of FRS 101 to help assess its fitness for purpose.

- User views on current and developing requirements of IFRS and on how we represent them in our responses to, and work with, the IASB.

- The level of direct company and investment community participation in Financial Reporting Lab projects.

Audit and Assurance

- External benchmark survey data on perceptions of audit quality and value.

- Monitor progress in the implementation of the recent extended audit committee and auditor reporting changes.

- Findings from our annual overview of our audit quality inspection activities. (We will increase the number of FTSE350 audits inspected in 2014/15 by roughly 25% as part of a phased introduction of a programme to cover FTSE 350 audits on average every five years, as proposed by the Competition and Markets Authority, while continuing to give due prominence to risk-based selection criteria.)

Actuarial oversight and standards

- Assess user and practitioner confidence in the relevance, clarity and reliability of actuarial information and in the competence and integrity of the actuarial profession through independent surveys, including comparisons with previous surveys and questions which examine the impact of changes to our Standards Framework.

Oversight, monitoring and enforcement

- The extent to which we have recruited sufficient resources and established suitable management and governance arrangements to enable us to fulfil our increased responsibilities in relation to audit inspection and oversight stemming from the Competition Commission recommendations and requirements of the EU Audit Directive.

Our people

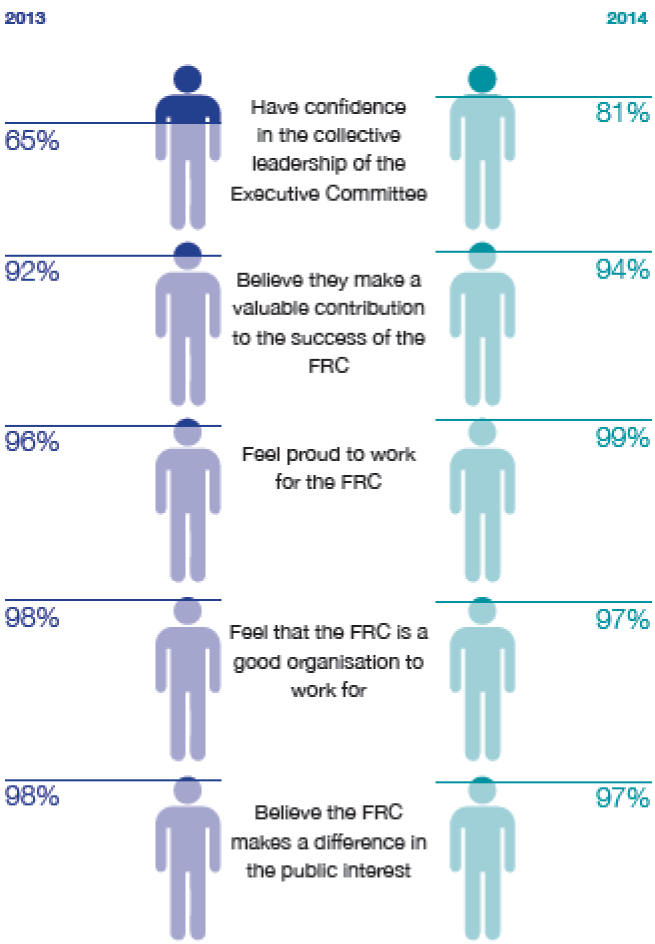
The complex technical issues that we address require up-to-date expertise and good judgement if the FRC is to operate effectively as a regulatory body. Of our 134 staff, 90 are members of either the accountancy or actuarial professional bodies or qualified lawyers.

During the year we have focused on developing and supporting our existing team, including a 360 degree feedback programme for 13 senior staff. We have recruited a director of investor engagement and additional expertise into the Financial Reporting Lab, Audit Quality Review Team, Corporate Reporting Review Team and the Professional Discipline Team.

Employee Engagement

Participation rates in our annual staff survey have increased year on year: 87.4% of our employees responded in 2014. The majority of indicators remain positive.

Staff speaking positively of the organisation



There was a strong positive feeling that people at the FRC live our Values.

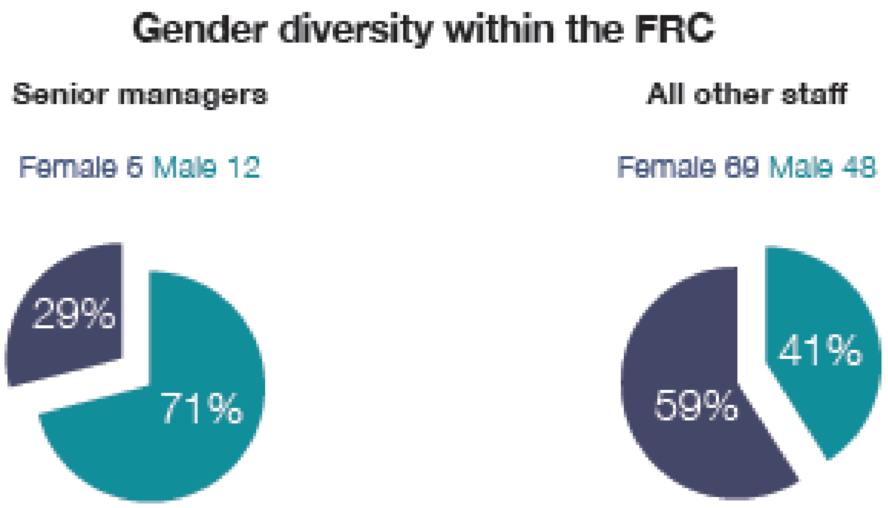
Development

In 2013/14 we introduced a new learning and development programme. The year ahead will see us further develop our Early Talent programme**,** which has already included the recruitment of an apprentice into the business support team. We are committed to providing opportunities for colleagues at various stages of their working career; and provide work experience places, internships and opportunities for individuals who are progressing their education through the less traditional routes.

Building on the progress in 2013/14 we have now launched an internal mentoring programme, proposed by a new member of the Professional Discipline team, which is another step in our commitment to providing staff with every available opportunity to develop their career. Colleagues have the opportunity to be mentored from all levels within the organisation all the way up to the CEO.

Diversity and Inclusion

We recognise the importance of diversity and inclusion both as an employer and as a regulator. By consciously seeking to understand and reflect the perspectives of colleagues from diverse backgrounds we believe that the FRC can, quite simply, operate more effectively. We value and demonstrate equal opportunity in recruitment, career development, promotion, training and reward for all employees.



Financial review

This Review is intended to give our stakeholders, including the professional bodies and levy payers who contribute through our non-statutory funding arrangements, an account of our expenditure and revenue.

Expenditure

Our total expenditure is managed under four main headings:

- Core operating costs
- Audit quality review costs
- Disciplinary case costs
- XBRL development costs

Core operating costs represent the cost of our key regulatory functions plus corporate costs and depreciation. Core operating costs in relation to our responsibilities for corporate governance, corporate reporting and audit are funded through levies on publicly traded, large private and public sector organisations plus contributions from the accountancy profession and from Government. Our actuarial activities are funded by levies on pension funds and insurance companies plus a contribution from the actuarial profession.

Audit quality review costs are recovered from the accountancy professional bodies.

Disciplinary case costs are recovered from the accountancy professional bodies for accountancy cases and from the actuarial funding groups for actuarial cases.

Following the publication of the new UK GAAP standard in 2013, the FRC has led a project to develop a set of XBRL taxonomies that complement the new accounting standards. This work has been funded by Companies House and the Data Strategy Board on behalf of BIS.

The expenditure necessary to fund the FRC's activities and meet key objectives is set out each year in the published Plan & Budget. Stakeholders are invited to comment on the priorities identified in the plan and the associated levels of expenditure required.

Total expenditure in the year was £26.0m compared to £25.5m in 2012/13, an increase of 1.9%.

	Actual 2013/14	Actual 2012/13	Budget 2013/14
Total expenditure by funding group:			
£m			
Core operating costs	18.0	16.1	17.9
Audit quality review costs	3.3	3.2	3.5
Accountancy disciplinary case costs	3.2	5.8	5.0
Actuarial disciplinary case costs	0.2	0.4	0.2
XBRL Development	1.3	0.0	1.3
Total	**26.0**	**25.5**	**27.9**

Total expenditure by cost type:	Actual 2013/14	Actual 2012/13	Budget 2013/14
£m			
Staff costs	14.7	13.7	15.1
Fees of non-executives, council and committee members	1.4	1.3	1.3
IT and facility costs	2.5	2.0	2.4
Travel and conferences	0.6	0.6	0.6
Legal, professional and audit fees	0.5	0.6	0.4
Contribution to EFRAG	0.3	0.3	0.3
XBRL Development	1.3	0.0	1.3
All other costs	1.3	0.8	1.3
Sub Total	22.6	19.3	22.7
Accountancy and actuarial disciplinary case costs	5.7	6.2	5.2
Less cost awards recovered	-2.3	0.0	0.0
Total	**26.0**	**25.5**	**27.9**

Comparison to prior year

Total expenditure increased by £0.5m compared to 2012/13. Core costs were up in total by £1.9m (12.4%), driven by increased staffing on priority projects and by facility costs as we took a lease at 125 London Wall to relocate from Aldwych House to avoid a substantial increase in rent there. Expenditure on research, and recruitment of both staff and non-executives were also higher along with the cost of staff training and development.

The cost of audit quality review rose by 3%.

The net expenditure on disciplinary case costs (accountancy and actuarial taken together, less cost awards) was 45.2% lower than prior year at £3.4m. Amounts recovered for cost awards (£2.25m in 2013/14) are included here and deducted from gross expenditure. Gross expenditure was £0.6m (9.7%) lower than prior year.

There was an increase of £1.3m to fund the development of the XBRL taxonomies from April 2013 onwards. The expenditure was incurred on IT licenses and on external technical resources to design the taxonomies.

Comparison to budget

Total expenditure was £1.9m (6.8%) lower than budget, the largest variance being in accountancy disciplinary case costs which were £1.8m lower. Whilst the number and complexity of the cases undertaken during the year was broadly as expected, one case did extend beyond the tribunal stage and is subject to an appeal. There were successful outcomes in a number of cases leading to awards of costs being made against other parties. These totalled £2.25m in 2013/14 compared to a nil budget.

Core operating costs were £0.1m higher, due mainly to additional rent and rates payable on the new offices during their fit out.

The cost of audit quality review was lower with staffing levels below budget. Despite this, the required number of audit reviews was carried out in the required timeframe.

Revenue

The funding requirements for each of the FRC's activities are set out each year in the Plan & Budget. Levy payers are invited to comment on the rates at which levies will be set in order to fund our operating costs.

The grant from Government and the total amounts to be collected from the professional bodies are agreed at the start of the year as part of the consultation process.

Ad hoc income streams, such as from publications, registration fees and professional services are included as part of total revenue.

During 2013/14 the FRC's total revenue was £26.1m (2012/13: £25.4m), an increase of 2.7%.

£m	Actual 2013/14	Actual 2012/13	Budget 2013/14
For Core Operating Costs			
Publicly traded companies	6.3	5.0	6.1
Large private entities	2.9	2.5	2.8
Public sector organisations	0.3	0.4	0.5
Insurance funds	1.0	1.1	1.1
Pension funds	1.0	1.1	1.0
Accountancy professional bodies	4.9	4.5	4.9
Actuarial profession	0.2	0.3	0.2
Government	0.5	0.5	0.5
Publications	0.7	0.4	0.5
Professional services & subscription income	0.3	0.2	0.3
Sub Total	**18.1**	**16.0**	**17.9**
For Audit Quality Review			
Accountancy professional bodies	2.4	2.4	2.8
Professional services & subscription income	0.9	0.8	0.7
Sub Total	**3.3**	**3.2**	**3.5**
For Accountancy Disciplinary Case Costs			
Accountancy professional bodies	**5.5**	**5.8**	**5.0**
less cost awards recovered	**-2.3**	**0.0**	**0.0**
Sub Total	**3.2**	**5.8**	**5.0**
For Actuarial Disciplinary Case Costs			
Insurance funds	0.1	0.2	0.1
Pension funds	0.1	0.2	0.1
Sub Total	**0.2**	**0.4**	**0.2**
For XBRL Development			
Companies House	0.7	0.0	0.7
Data Strategy Board	0.6	0.0	0.6
Sub Total	**1.3**	**0.0**	**1.3**
Total	**26.1**	**25.4**	**27.9**

Comparison to prior year

The increase in revenue compared to 2012/13 enabled the FRC to allocate additional resources (an additional £2.1m (13.1%) of core operating costs compared to 2012/13) to priority projects in accounting, reporting and corporate governance. The levy on publicly traded companies and large private entities together with the contribution from the accountancy professional bodies provided most of the additional amount. Our levy rates were increased by between 2% and 8% and we benefited from a 5.5% increase in the market capitalisation (a factor in determining the amounts individual companies pay) of listed entities. The contribution received from the accountancy professional bodies increased by 8.9%.

The annual funding we seek each year for the investigation and prosecution of accountancy and actuarial cases is set to match the net expenditure incurred. As explained above, in 2013/14 net expenditure reduced by 45.2% compared with expenditure in 2012/13. Gross expenditure was 9.7% lower.

Development of the XBRL taxonomies began during 2013/14. £1.3m was provided by Companies House and the Data Strategy Board to fund technical resources and the annual IT licenses.

Comparison to budget

Revenue in total was £1.8m (6.5%) lower than budget. Much of this reduction was caused by the reduced net funding requirement for accountancy cases due to cost awards received.

The amounts collected from both publicly traded and large private entities to fund core operating costs were also higher than budget because there were more entities in these groups contributing to the levy than originally forecast. This increase was partially offset by lower than budgeted receipts from public sector organisations.

The contribution required from the accountancy bodies to fund our AQR activities was lower than budget largely due to lower expenditure on staffing and also to higher than expected income from third party inspection work.

Balance Sheet

The balance sheet at 31st March 2014 is included in the financial statements.

In the year a surplus result of £162k was achieved and this has been added to general reserves. Total reserves therefore increased to £7.7m of which £4m relate to specific case funds and £3.7m are general reserves.

There are a number of significant movements on the balance sheet, caused mainly by the office relocation to London Wall. Tangible assets have increased by £529k representing the capital costs incurred to 31st March on fitting out the new office.

Debtors have increased by £0.7m reflecting the amount due (£1.1m) from the landlords of the new premises to cover their contribution to the fit out. This was received in May 2014. Similarly, creditors are higher by £2.5m, with the majority of the increase due to the amounts payable to the contractors working on the office fit out and the deferral of the landlord's contribution to the works which has been treated as a lease incentive.

During the year cash increased by £1m and investments by £0.4m

Approval

This report was approved by the Board of Directors on 2nd July 2014 and signed on its behalf by

Anne McArthur

Company Secretary

9 July 2014

2 – Governance

Introduction

This Governance report details the governance structure of the FRC which has been designed to facilitate effective management to deliver the long-term success of the organisation.

The Financial Reporting Council Limited is a company limited by guarantee incorporated in England and Wales, with its primary operations based at 8th Floor, 125 London Wall, London EC2Y 5AS

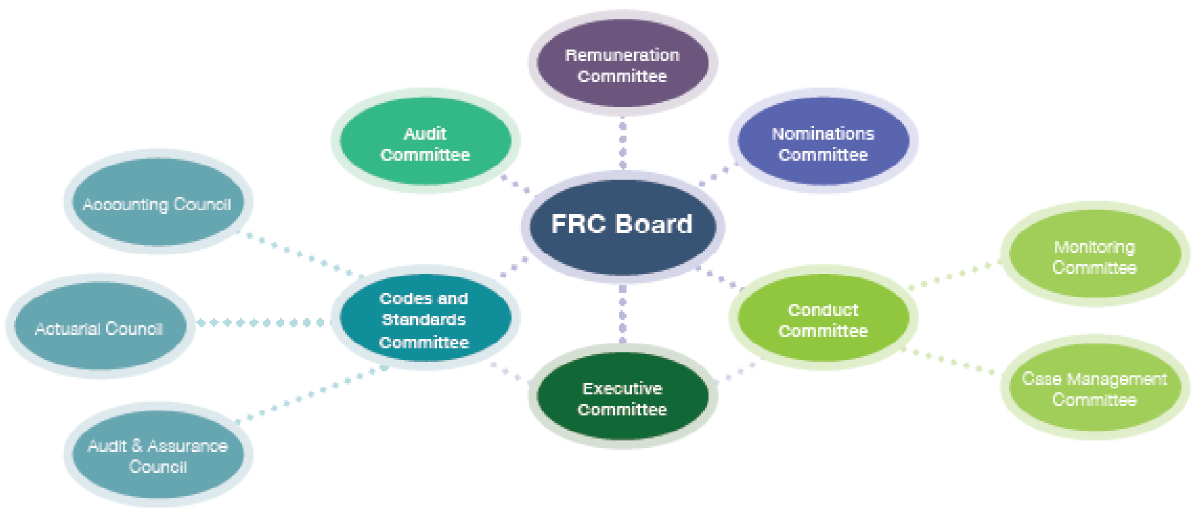
Compliance with the UK Corporate Governance Code

The Board is committed to high standards of governance and believes that its UK Corporate Governance Code (the Code) is the appropriate benchmark for how it conducts itself to the extent that it is applicable to the FRC. The Board complies with the Code or explains how the underlying principles have been met.

The FRC does not have shareholders in the usual sense. However, it has a wide range of stakeholders and conducts an extensive dialogue with them through an annual open meeting, the annual business plan, the annual report and individual consultation documents.

Governance Overview

The aim of the FRC is to promote high quality corporate governance and reporting to foster investment. The principal activities exercised in support of this aim are set out on pages 19 - 20 and comprise setting codes and standards, monitoring the quality of corporate reporting and audit and overseeing the regulatory activities of the professional bodies and operating disciplinary schemes. These activities are carried out by the Board and its Conduct Committee and Codes & Standards Committee supported by the Councils and the Monitoring and Case Management Committees. The Board, the Committees and Councils are supported by the FRC's staff (the "Executive").



The ***Executive Committee*** *is responsible for assisting the Chief Executive in his role including recommending the strategic direction of the FRC to the FRC Board, providing the day-to-day oversight of the work of the FRC, implementing the FRC's annual business plan and advising the Board on the FRC's budget.*

The ***Codes & Standards Committee*** *is primarily responsible for advising the FRC Board on maintaining an effective framework of UK codes and standards for corporate governance, stewardship, accounting, auditing and assurance, and actuarial technical standards.*

The ***Conduct Committee*** *is responsible for exercising the statutory powers delegated to the Committee in relation to the review of corporate reports, and primarily responsible for corporate reporting reviews, audit quality reviews, monitoring Recognised Supervisory and Qualifying Bodies, professional discipline, and oversight of the regulatory responsibilities of the accountancy and actuarial professional bodies.*

Board of Directors

As at 1 May 2014

1 Sir Winfried Bischoff
2 Gay Huey Evans
3 Stephen Haddrill*
4 Mark Amour
5 Sir Brian Bender
6 David Childs
7 Elizabeth Corley
8 Olivia Dickson
9 Paul George*
10 Nick Land
11 Roger Marshall
12 Melanie McLaren*
13 Keith Skeoch
14 John Stewart
15 Jim Sutcliffe

* Executive Director

Changes to Board Membership and Board Diversity

Changes to Board membership from 1 April 2013 to 31 March 2014

	Term end date	Term start date
John Stewart		01 March 2014
Sir Brian Bender		01 March 2014
Sir Steve Robson	31 October 2013	

Changes to Board membership from 31 March 2014 to 1 July 2014

	Term end date	Term start date
Baroness Hogg	30 April 2014	
Sir Winfried Bischoff		1 May 2014
Glen Moreno	30 April 2014	
Peter Chambers	30 April 2014	
David Childs		1 May 2014
Richard Fleck	30 April 2014	

The Board considered its composition measured against the UK Corporate Governance Code in 2012/13 and concluded that at least half the Board excluding the Chairman comprised independent Non-executive Directors. The Board reached this decision by considering not only the circumstances set out in the Code but also, given the functions of the FRC, any relationships or significant links with those regulated by the FRC.

The letters of appointment for each Board Member are available on the FRC website.

The FRC's commitment to promoting equality and diversity extends to the membership of the Board and its Committees. The Board satisfies this commitment by keeping under review the mix of skills and experience required on the Board and its Committees. Particular attention is paid to gender diversity. Although no specific targets are set, at the time of writing 27% of Board members, 33% of Conduct Committee's members, 20% of Codes & Standards Committee members and 33% of Executive Committee members are female

The role of the Board

The Board is responsible for the overall strategy of the FRC and its management and culture as well as determining the nature and extent of the significant risks to be taken in achieving the FRC's strategic objectives.

The Board is supported by three governance committees - Audit Committee, Nominations Committee and Remuneration Committee - and by the Executive Committee, Codes & Standards Committee and Conduct Committee. The Schedule of Matters reserved to the Board and the terms of reference for each of the Committees together with the FRC's Articles of Association are published on the FRC website. https://frc.org.uk/About-the-FRC.aspx

Regulatory powers reserved to the Board include the issuing and maintenance of codes and/or standards for corporate governance, stewardship, corporate reporting, accounting, auditing, assurance services and actuarial work; the exercise of the functions of the Secretary of State under Part 42 Companies Act 2006 (i.e. the oversight of the regulation of statutory auditors) and the exercise of the functions of the Independent Supervisor of the Comptroller & Auditor General under Part 42 Companies Act 2006.

The work of the Board in 2013/14

During the year the Board focused on the FRC's work in pursuit of the six broad objectives in the FRC's Plan for 2013/14, while taking account of emerging developments and reviewing the risks associated with each of the objectives. The key decisions taken are reported in the Strategic Report. All key decisions were taken with the benefit of the advice of the Board's Committees and Councils and focussed on the effects of any decision on, and the benefits to, the FRC's various stakeholders.

The Board considered the FRC's powers following the reforms of 2012, and the potential consequences of the EU Audit Regulation and Directive and the recommendations of the Competition Commission, and made representations to the Secretary of State in relation to the FRC's suite of responsibilities and functions.

The Board considered its approach to regulation and how its activities were aligned to the public interest and published "The FRC and its Regulatory Approach (including Transparency Arrangements)". The Board also approved and published "Principles for the development of Codes, Standards and Guidance" prepared by the Codes & Standards Committee which complemented the Regulatory Approach.

The Board considered its own oversight of the various activities undertaken by the FRC and strengthened reporting lines by requesting and receiving quarterly reports from the Executive Directors of Conduct and Codes & Standards in addition to reporting on progress on key projects.

The Board agreed not to exercise an option to remain at the premises at Aldwych House and to negotiate a lease of premises at 125 London Wall and delegated authority to a group led by Mr Nick Land to approve the detailed arrangements.

The minutes of FRC Board meetings and all its decisions are published and available on the FRC website.

Board Effectiveness

Board effectiveness is reviewed every year. This year a review of the Board and its committees was conducted by Tracy Long of BoardroomReview. Ms Long is an independent advisor and has no other connection with the Company. The evaluation process undertaken during the summer of 2013 involved interviews with the Chairman, each Board member, the Company Secretary, and a sample of members of the Conduct Committee and Codes & Standards Committee. A report was prepared by Ms Long and discussed by the Board and then the Conduct and Codes & Standards Committees at meetings in the Autumn of 2013.

Ms Long noted that the Board demonstrated strengths in the following areas: Board contribution and composition, Chairmanship of the Board and its Committees, knowledge of the stakeholder landscape, ability to contribute to strategy, leadership of the CEO, approach to remuneration, schedule of Board meetings and structure of agendas, quality of information and Board and Committee support.

Considerations and challenges for the Board following the review were: future Board composition and size, clarity of the governance structure, use of the strategic awayday, risk oversight and executive succession planning. The Board has already taken actions to address each of the challenges and further action is planned taking into account the further review detailed below. Specific steps already taken include allocating more time to the regular consideration of strategy, a wholesale review of the FRC's risk management policy and register and a review of the skills and experience required on the Board in view of its three year plan published in 2013. The skills matrix produced informed the search for the non-executive directors and the appointments of Sir Brian Bender and John Stewart on 1 March 2014. The Board noted that the size of the Board remained appropriate in view of the three year plan and the need for Board members to join the membership of the Conduct Committee and the Codes & Standards Committee.

In addition to Ms Long's review, the Conduct Committee and Codes & Standards Committee undertook further reviews and the Codes & Standards Committee initiated a review of the effectiveness of the Councils. The Board considered the outcome of all of the reviews in January 2014.

Taken together, the reviews provide evidence that one year on from reform the Boards, Committees and Councils were working well with good chairs and effective contributions from their members and that much has been achieved since the effective date of the FRC reforms in July 2012. Considerations and challenges for the Board following the review were:

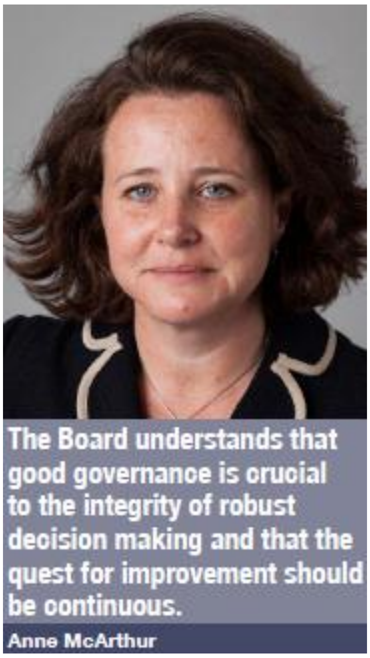
- the size of the Conduct Committee;
- ways of improving the communication between the Board and its Committees;
- improving the clarity of the roles and relative roles of each part of the governance structure;

- increasing focus on the future and strategic planning (including risk);

- improving the assessment and reporting of FRC performance.

Specific steps already taken include improved reporting of the activities of the Board to its Committees and vice versa; the development and publication of “The FRC and its Regulatory Approach” which sets out the roles of each part of the governance structure; more focus on the future and strategic planning through further scheduled awaydays; and the development of effectiveness indicators, which are included the FRC Plan 2014/15.

The Board has agreed a program for the review of the effectiveness of the Board and its Committees, the Councils and the Committees of the Conduct Committee in the coming year.



Board rotation

As the Directors of the FRC are also its members, the submission of Directors for re-election would not be meaningful. The Board has put in place an alternative to annual re-election; its annual effectiveness evaluation includes consideration of the continuation of each of the Directors and the Secretary of State has been invited to consider the continuation of the Chairman and Deputy Chairman on an annual basis.

Board Committees

Audit Committee

The Audit Committee assists the Board in fulfilling its responsibility for monitoring the quality and integrity of the accounting, auditing and reporting practices of the FRC. The Committee's main purpose is to scrutinise the FRC's accounting and financial reporting and the audit of the FRC's financial statements.

Responsibilities

- Reviewing the financial statements to ensure compliance with relevant statutory requirements.

- Reporting to the Board on the appropriateness of the accounting policies used in preparing the financial statements.

- Advising the Board on whether the Committee believes the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the company's performance, business model and strategy.

- Overseeing the relationship with the external auditor.

- Carrying out in-depth reviews of specific areas of financial reporting, risk and internal control.

Committee Meetings

Meetings are attended by the three independent non-executive directors and, by invitation, the Chief Executive, the Company Secretary, the Finance Director and the Head of Finance. The external auditor, haysmacintyre is also invited to attend each meeting. The Committee meets with the external auditor in private at least once a year and, in addition, the chair of the Committee meets with the auditor privately from time to time.

Main activities of the Committee during the year

During the year the Committee focussed on:

Financial reporting

The Committee has the responsibility to review with management the appropriateness of the annual financial statements. During the year the Committee oversaw the transition to FRS102 which replaced IFRS as the basis for preparing the financial statements. Other matters considered included:

- The suitability of accounting policies and practices;

- The clarity of disclosures and compliance with the relevant financial reporting standards; and

- Advising the Board on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the company's performance, business model and strategy.

To assist with this review, the Committee receives reports from the Finance Director and from the external auditor on the outcomes of the annual audit.

In relation to the 2013-14 financial statements, the key reporting issues considered by the Committee were as follows:

- **XBRL expenditure and recovery**

The FRC acted as principal on a project to develop a set of taxonomies that complement the new UK GAAP. All expenditure incurred was recovered via separate contractual agreements with the Data Strategy Board and Companies House. The Committee considered the most appropriate way to present these items in the financial statements and discussed the issue with the auditors. The Committee concluded that, as the FRC was acting as principal the income and expenditure should be shown gross.

- **Landlord contribution to the fit out costs of new premises**

Work commenced on March 4^{th} to fit out the new premises at 125 London Wall. A financial contribution to the fit out works was made by the landlord, J P Morgan. The Committee discussed how this contribution should be presented in the financial statements and agreed that it should be recognised as a lease incentive.

- **Fines and cost awards received in relation to accountancy disciplinary cases**

In previous years when fines and costs awards had been received, these were not included in our financial statements and were passed directly to the relevant participating professional body. A disclosure was made to that effect in the notes to the accounts. The Committee discussed whether this remained appropriate, concluding that cost awards received and then remitted to the relevant professional body should be included in the financial statements of the FRC as adjustments to both income and expenditure and disclosed in the notes. The accounting policy shown in the notes to the accounts was amended accordingly. Fines continue to be excluded from the financial statements.

External audit

Haysmacintyre were appointed as auditor in 2013 following a tender process involving three firms.

The Committee reviewed the detailed audit plan put forward by Haysmacintyre which included their assessment of the key areas of risk. For the 2013/14 financial year these were identified as:

- Revenue recognition including completeness of levy income
- Management override of controls
- Reputational risk – financial reporting

- Reputational risk – disciplinary cases
- Disciplinary case costs and provisions

To assess the effectiveness of the auditor, the Committee reviewed the extent to which the auditor fulfilled the agreed audit plan and any variations from it. The Committee also reviewed the auditor's report of major issues arising during the course of the audit. The Committee challenged the work done by the auditor to test management's assumptions and estimates made for each risk area.

The Audit Committee is satisfied with the auditor's effectiveness.

To protect the objectivity and independence of the external auditor, the FRC has a policy whereby no non-audit services are permitted to be carried out by the external auditor.

Internal control

During the year the Committee reviewed aspects of internal controls including disciplinary cases, IT security and the roles and responsibilities within the finance department.

The Committee received regular updates on the financial performance of the company including its expenditure compared to budget and progress made in collecting the funds required to fully support its operations.

The Committee considered proposals for the required funding of the XBRL project and approved the associated expenditure.

The Committee also reviewed the comparative costs of future accommodation options for the FRC. A recommendation was made to the Board that the lease at Aldwych House not be renewed and that alternative space be acquired at 125 London Wall.

Because of its size and nature it is not considered appropriate for the company to have an internal audit function. Regular dialogue is maintained with the external auditor and the Committee takes into account the assurance derived from their work. The Committee will keep this matter under review.

Risk management

During the year the Committee reviewed the risk register and the supporting policy to ensure that significant business risks were appropriately managed. Reports were received from management identifying key strategic and operational risks to the FRC and on the mitigating actions put in place.

Nick Land

Chairman, Audit Committee

Nominations Committee

Responsibilities:

Leading the selection process and making recommendations for the appointment of Directors of the FRC (except for the Chair and the Deputy Chair who are appointed by the Secretary of State) and co-opted members of the Conduct and Codes & Standards Committee.

Approving the selection process for members of the Case Management Committee, Monitoring Committee and Accounting, Audit & Assurance and Actuarial Councils.

Overseeing the selection process and approving the appointments of the FRC's General Counsel & Company Secretary, Executive Counsel and the Convener to the FRC's Accountancy and Actuarial Schemes.

During the year the Committee:

- Recommended to the Board the reappointments of Peter Chambers, Elizabeth Corley, Richard Fleck, Nick Land and Roger Marshall.

- Reviewed the composition of the Board by assessing the skills and experience of continuing Board members and the skills and experience necessary in view of the FRC's three year plan. The Committee led the selection process for the Chair of the Conduct Committee and non-executive members of the Board against the criteria identified during that review process. The selection process was conducted with the involvement of an independent assessor, Rachel Lomax, and with the assistance of JCA Group, search consultants. Neither Ms Lomax nor JCA have any other connection with the FRC. The process involved open advertising and interviews by representatives of the Committee and Ms Lomax. Appointments were recommended to the Board based on merit and with due regard for the benefits of diversity on the Board. The Committee recommended to the Board the appointments of David Childs for his understanding of the legal issues facing corporate Britain and Sir Brian Bender and John Stewart for their combined knowledge of international matters and regulation.

- Approved the appointment of the Appointments Committee under the Accountancy and Actuarial Schemes and the Auditor Regulatory Sanctions Procedure and the FRC's Deputy Executive Counsel, approved an increase in the size of the Actuarial Council until the summer of 2015, and reviewed proposals for the appointment of the FRC's Director of Strategy.

Appointments of the Chairman and Deputy Chairman

During the year, the Department for Business, Innovation & Skills led the search for the FRC Chairman and Deputy Chairman to succeed Baroness Hogg and Glen Moreno. The appointments of Sir Winfried Bischoff and Gay Huey Evans were made by the Secretary of State. The Committee received regular updates on progress and provided input on the skills and background required for the roles.

Remuneration Committee

Responsibilities:

Determining and reviewing the remuneration policy for the FRC and for determining the remuneration of the Chief Executive, members of the Executive Committee and the Executive Counsel.

During the year the Committee:

- Reviewed the FRC's Reward Policy and Performance Management Policy with a particular view to ensuring links between the FRC's mission, performance and reward, clarity of assessment criteria and consistency of application. The Committee reviewed and approved the collective and individual objectives of the Executive Committee and the criteria for bonus awards to members of the Executive Committee and the Senior Leadership Group.

- Approved the budgetary limits for the salary review and bonus pool for all employees, and agreed that the criteria for the award of a company-wide bonus had been met and supported a recommendation to the Board by the Chief Executive in that regard.

- Reviewed and approved the remuneration of the Chief Executive pursuant to recommendations from the Chairman; reviewed and approved the remuneration of members the Executive Committee and the Executive Counsel pursuant to recommendations from the Chief Executive; and reviewed remuneration proposals in relation to the Senior Leadership Group.

- Reviewed the expenses of both the executive and non-executive Board members and reviewed the remuneration of the Chair of the Conduct Committee in the light of the proposed appointment of David Childs, recommending no change from the existing annual fees of £90,000.

The Committee's determination of the remuneration of the executive Directors was in accordance with the criteria set out in the Remuneration Policy described below and against the collective and individual objectives approved at the beginning of the year as well as affordability. The salary reviews determined by the Committee were consistent with the standard salary reviews awarded to all FRC employees. The Committee was assisted in its consideration by the views of the Non-executive Directors on the performance of the FRC Executive and all members of the Executive Committee and by the results of the annual FRC staff survey.

Executive Committee

Responsibilities

Assisting the Chief Executive in the performance of his duties including:

- Recommending strategic direction to the FRC Board.
- Providing day to day oversight of the work of the FRC, its operational policies and protection of the FRC reputation.
- Overseeing the implementation of the FRC business plan.
- Making recommendations to the FRC Board on the budget, business plan, Board agenda and management of the organisation.
- Debating and resolving issues affecting the Codes & Standards and Conduct Divisions.

During the year the Committee recommended strategic direction to the Board through its work on the Board Strategy Day and Annual Plan & Budget and on discrete issues reserved to the Board. The Committee exercised oversight of the work of the FRC, regularly reviewing progress against the FRC Plan, the resources available for the work and the FRC budget, risk (including reputational risk), and whether operational policies were fit for purpose. The Committee reported to the Board regularly on progress.

The Committee considered the options available to the FRC at the end of the lease of its premises at Aldwych House and recommended to the Board that an option to extend the lease should not be exercised and that a lease of premises at 125 London Wall should be agreed. The Committee also kept under review the operation to move premises. The Committee also agreed that the FRC should change its IT provider and considered the risks associated with doing this in the same period as moving premises.

The Committee continued its response to feedback from the previous year's staff survey: in particular, the Committee developed the FRC's Learning & Development policy and took steps to ensure that learning and development is integral to the FRC's performance management processes.

The Executive Committee met 11 times during the year on a formal basis and more often on an informal basis. Membership of the Committee was as follows:

Stephen Haddrill	- Chief Executive
Paul George	- Executive Director, Conduct
Melanie McLaren	- Executive Director, Codes & Standards
Anne McArthur	- Company Secretary & General Counsel
Graham Clarke	- Finance Director
Mridul Hegde (to 31/12/13)	- Executive Director, Strategy
Chris Hodge (from 01/01/14)	- Executive Director, Strategy

Codes & Standards Committee

Responsibilities:

Advising the Board on maintaining an effective framework of UK codes and standards for governance, accounting, auditing and actuarial work

Monitoring international developments to ensure appropriate and effective UK input in to international standards setting

Identifying and assessing the current, emerging and potential risks to the quality of corporate governance and reporting in the UK and approving the adequacy of actions to mitigate those risks

Approving operating plans for the FRC's codes and standards activities and overseeing the quality of work and delivery of the principal elements of those plans

Overseeing the work of the Councils in accordance with the strategic direction provided by the FRC Board, ensuring that the resources of the whole of the FRC relevant to a particular issue are properly deployed

Appointing members to the Accounting, Audit & Assurance and Actuarial Councils and overseeing the appointment of any groups by the Councils

During the year the Committee exercised oversight of the work of the Codes & Standards Executive and the Accounting, Audit & Assurance and Actuarial Councils. This included the approval of work plans and monitoring progress against the plans.

The work of the Committee changed during the year in that, following the Board and Committee effectiveness review and clarification of the Committee's role, the Committee spent more time on draft codes and standards to be tabled to the Board with the advice of the respective Council. This led to the Committee leading a review to develop and recommend to the Board principles to inform decisions on the development of codes, standards and guidance.

On international developments, the Committee supported the FRC's active engagement in the development of international standards and processes by sponsoring the membership of FRC representatives on bodies including the IAASB, the IASB, and the Accounting Standards Advisory Forum. The Committee considered in detail, and advised the Board, on the IASB Conceptual Framework and the implementation of the EU Accounting and Audit Directives.

The Committee agreed the establishment of a set of principles for the rotation of Council and Committee members and reviewed and refreshed Council membership: details of Council Memberships can be found on the FRC website.

Conduct Committee

Responsibilities:

Exercising the functions delegated to the Conduct Committee by the Secretary of State under the Companies Act 2006 and the Companies (Audit, Investigations and Community Enterprise) Act 2004.

Advising the Board on the exercise of the functions delegated to the Board by the Secretary of State under the Companies Act 2006.

Advising the Board on the approach to be taken to non-statutory oversight of the actuarial and accountancy professions.

Exercising the functions delegated to the Conduct Committee in accordance with the Accountancy and Actuarial Schemes.

Deciding whether to commence a supervisory inquiry, and determining the scope of any such inquiry and what, if any, action to be taken on its conclusion.

Identifying and assessing the current, emerging and potential risks to the quality of corporate governance and reporting in the UK and approving the adequacy of actions to mitigate those risks.

Appointing members of the Financial Reporting Review Panel, the Monitoring Committee and Case Management Committee.

During the year the Committee had oversight of the varied work of the Conduct Executive. In doing so the Committee approved the Conduct Executive's work plan and monitored progress against the plan with a focus on the quality, timeliness and consistency of the work and also the adequacy of resources both during the year and in the future in view of the changes recommended by the Competition Commission and consequent to the EU Audit Regulation and Directive.

On Corporate Reporting Review the Committee exercised its statutory power to require information and/or explanations on three occasions, each time from the company concerned where the information was not provided on a voluntary or timely basis.

On Professional Discipline, the Committee has various specific responsibilities under the Accountancy and Actuarial Schemes and, pursuant to these responsibilities, the Committee commenced 11 investigations and received Formal Complaints in relation to two matters and decisions to close investigations in two matters, and set and reviewed the budgets in all active disciplinary cases. The Committee also reviewed the Scheme, Regulations and Guidance and recommended changes to the Schemes to the Board.

On Audit Quality Review the Committee consulted on and approved Sanctions Guidance under the Auditor Regulatory Sanctions Procedure.

On Professional Oversight, the Committee advised the Board on the appropriate action in response to failings by one of Recognised Supervisory Bodies identified.

The Committee approved reappointments to the Financial Reporting Review Panel and appointments and reappointments to the Case Management Committee: details of the Panel and Case Management Committee Memberships can be found on the FRC website.

Directors' Remuneration Report

Remuneration Policy

The remuneration of Non-executive Directors, including the Deputy Chairman is determined by the Board. The Board determines the remuneration of Non-executive Directors by assessing the responsibility, workload and time commitment to the role and by calculating a daily rate of fees comparable to fees paid by other regulators and in relation to comparable roles within the public sector. Non-executive Directors are paid basic annual fees of £25,000, additional fees for membership of the Conduct Committee or Codes & Standards Committee of £10,000 and for chairmanship of the Audit and Remuneration Committees of £5,000. The Chair of the Conduct Committee is paid fees of £90,000 and the Chair of the Codes & Standards Committee is paid £60,000. Council Chairs are paid annual fees of £50,000 plus any supplemental fees determined by the Remuneration Committee for work falling outside a Chair's normal duties.

The Deputy Chairman receives a basic annual fee of £35,000 to reflect additional responsibilities. Board member fees were reviewed during the FRC reforms in 2012 and will be reviewed again this year.

The Remuneration Committee determines the framework and policy for the remuneration of the FRC Chairman and the Executive Directors and determines the total individual remuneration package of the FRC Chairman and the Executive Directors. The FRC does not have shareholders in the usual sense and so has not consulted shareholders on remuneration. The remuneration of the Executive Directors comprises the following components: salary, bonus of up to 20% of annual salary, pension contributions of up to 10% and other contractual benefits including private health and dental cover, death in service and permanent health insurance. As with all members of the Executive, both salary review and bonus eligibility depends on Executive Directors achieving the necessary ratings bandings for performance and 'citizenship' – living the FRC Values. Executive Directors are treated differently from other members of staff in that they are required to achieve higher citizenship ratings to qualify for a bonus and higher performance and citizenship ratings to achieve a salary review. The performance of Executive Directors is assessed against both individual and collective objectives. 25% of each Executive Director's bonus potential is assessed on the extent to which the collective objectives have been achieved and the Executive Director's contribution to achievement.

The total remuneration and benefits received are shown in the following table, which has been subject to audit (see also note 3 to the Financial Statements).

	2013/14	**2013/14**	**2013/14**	**2013/14**	**2013/14**	**2013/14**	**2012/13**
Non-executive Directors	**Fees/ Salary**	**Bonus**	**Pension**	**GHI**	**Private Medical / Dental**	**Total**	**Total**
Baroness Hogg	120,000					120,000	120,000
Glen Moreno (1)	23,333					23,333	33,750
Mark Armour	25,000					25,000	18,750
Sir Brian Bender (from 1 March 2014)	2,917					2,917	-

Peter Chambers	37,917					37,917	37,800
Elizabeth Corley (2)	27,083					27,083	23,750
Olivia Dickson	50,000					50,000	37,500
Richard Fleck	90,000					90,000	90,000
Gay Huey Evans	35,000					35,000	26,250
John Kellas (to 30 June 2012)	-					-	17,500
Nick Land	55,000					55,000	53,750
Rudy Markham (to 30 June 2012)	-					-	5,000
Roger Marshall	85,000					85,000	59,375
Sir Steve Robson CB (to 31 October 2013)	20,417					20,417	26,250
Keith Skeoch (3)	35,000					35,000	28,750
John Stewart (from 1 March 2014)	2,917					2,917	-
Jim Sutcliffe	60,000					60,000	60,000
Timothy Walker (to 18 October 2012)	-					-	33,231
Sub-total	**669,584**	**0**	**0**	**0**	**0**	**669,584**	**671,656**
Executive Directors							
Stephen Haddrill (4) (6)	355,239	67,495	35,524	4,306	-	462,564	451,283
Paul George (4) (5) (6)	288,564	41,000	28,856	3,498	2,621	364,538	357,126
Melanie McLaren (from 2 July 2012) (4)(5) (6)	276,750	39,500	27,675	3,355	-	347,280	335,373
Sub-total	**920,553**	**147,995**	**92,055**	**11,159**	**2,621**	**1,174,382 (7)**	**1,143,782**
Grand Total	**1,590,137**	**147,995**	**92,055**	**11,159**	**2,621**	**1,843,966**	**1,815,437**

Where Directors were appointed during the year, the amounts shown are for the period from the date of their appointment. The amounts paid to Richard Fleck, Roger Marshall, John Kellas, Jim Sutcliffe and Timothy Walker in the prior year included the remuneration payable in respect of their roles as Chairs of Operating Bodies under the pre-reform structure.

(1) Glen Moreno waived his fees from 1 December 2013.

(2) Elizabeth Corley waived her Remuneration Committee Chair fees of £2,083 in favour of charity in 2013/14.

(3) From 1 April 2012 Keith Skeoch waived his fees in favour of charity.

(4) Executive Directors are entitled to receive pension contributions and other benefits. The figures shown are the cash equivalents of their full pay and benefits

(5) Paul George and Melanie McLaren were remunerated as FRC employees before being appointed to the Board on 2nd July 2012. For both directors the equivalent full year remuneration is shown. Paul George was employed throughout the prior year. For Melanie McLaren the remuneration from her appointment as an employee on 11 June 2012 was £253,841.

(6) The average salary and reward increases including the cash equivalent benefits were 2.5% in 2013/14 for all staff including the Executive Directors.

(7) Total Directors' remuneration in 2013/14 amounted to 12.8% of total company remuneration (2012/13: 12.5%).

Board and Committee Member attendance for the period 1 April 2013 to 31 March 2014.

	FRC Board	Nominations Committee	Remuneration Committee	Audit Committee	Codes & Standards Committee	Conduct Committee
Baroness Hogg	8/8	3/3	3/3			
Glen Moreno	6/8	2/3				
Stephen Haddrill	8/8	3/3				
Gay Huey Evans	7/8	2/3				10/12
Mark Armour	8/8	3/3		5/5		
Sir Brian Bender	1/1	0/0				0/1
Peter Chambers	7/8	2/3	1/1			
Elizabeth Corley	8/8	3/3	2/2			
Olivia Dickson	8/8	3/3			7/7	
Richard Fleck	8/8	3/3				12/12
Paul George	8/8					12/12
Roger Marshall	7/8	3/3			5/7	
Melanie McLaren	8/8				7/7	
Nick Land	8/8	3/3	3/3	5/5	5/7	
Sir Steve Robson	4/5	1/2			3/4	
Keith Skeoch	6/8	2/3		4/5	5/7	
John Stewart	1/1	0/0			0/1	
Jim Sutcliffe	7/8	3/3			7/7	
Keith Barton					7/7	
Peter Elwin					5/7	
Allister Wilson					6/7	

Lillian Boyle						12/12
Peter Chambers						11/12
Hilary Daniels						11/12
Mark Eames						10/12
Jan Kamieniecki						12/12
John Kellas						12/12
Lois Moore						12/12
Malcolm Nicholson						12/12
Joanna Osborne						11/12
Martin Slack						9/9
Philip Taylor						10/11
Ian Wright*						4/12

*Acting Deputy Chair, Financial Reporting Review Panel – receives papers and is invited to meetings as necessary.

Principal Risks

Risk management is integral to the FRC's business planning and reporting systems and forms part of day-to-day management practice. It is led from the FRC Board and provides a focus for the procedures and activities of the organisation. The Board regularly reviews the likelihood and potential impact of risks to the achievement of the FRC's mission, and assesses the actions being taken by the executive to manage and mitigate these risks.

Reflecting the FRC's current assessment of the state of corporate governance and reporting in the UK, the Board has identified the following principal risks. These risks include the potential impact of events or developments in the markets that reduce the overall effectiveness of the UK regulatory framework for corporate governance and reporting. They also include risks that, if they materialised, might significantly compromise the FRC's ability to play its proper role within the wider regulatory framework.

Risk	What the FRC does to address the risk
Fail to contribute effectively to the wider regulatory framework for corporate governance and reporting	Maintain a close dialogue with Government and other regulators to ensure that the FRC's work supports and is supported by others' regulatory activities - including close liaison with the prudential and conduct regulators and constructive working relationships with the accountancy and actuarial professional bodies. Publish a clear statement of FRC regulatory approach and engage with range of stakeholders to promote understanding of the FRC's role. Communicate clearly the FRC's views on the state of corporate governance and reporting in the UK, including both its strengths and potential weaknesses.
Fail to identify and respond to developments in the markets, including international developments that might impact on the UK	Consult regularly and extensively on the state of corporate governance and reporting in the UK to inform FRC priorities and assess the impact of existing initiatives. Gather, report on and respond to issues identified from monitoring activities. Research key aspects of corporate governance and reporting. Keep in close touch with EU and international developments.
Inadequate FRC powers to support its mission	Keep the effectiveness of the FRC's powers and functions under review following the reforms to its powers and structure introduced jointly by Government and the FRC Board in 2012. Support Government in implementing the changes to the regulatory arrangements the new EU Audit Directive will require.

Fail adequately to influence EU and international initiatives	Ensure that sufficient priority and resource is dedicated to influencing EU and international bodies, including the EU aspects of negotiations and the work of the international standard setters (notably the IASB, IAASB and the IAA). Work closely with other regulators and Member States to influence European bodies, including ESMA, EFRAG and EIOPA. Going forward, develop strategies for engaging further with IFIAR, IOSCO and international framework bodies, including the IIRC.
Impact of a major corporate failure	Seek all available evidence quickly to take a position and make this public. Follow up with any necessary action and assure the public of this when appropriate. In relation to an event involving a major audit firm, coordinate with other public bodies and with the major audit firms to maintain contingency plans to minimise the impact of such a failure on the quality of reporting and audit in the UK.
Fail to conduct effective monitoring, investigatory or enforcement functions	Base monitoring activities on an analysis of the entities and sectors where problems are most likely to arise Build on the extensive reforms to the FRC disciplinary schemes. Undertake supervisory inquiries to develop a robust evidence base before announcing investigations. Communicate policies in relation to conduct activities and the outcome of individual interventions as fully as the current framework of powers permits.
Fail to maintain adequate skills at Board and executive level	Competitive and transparent recruitment, clarity in setting organisational and personal objectives; board effectiveness review; and an openness to constructive challenge and debate from inside and outside the governance structure.
Fail to secure sufficient resources	Consult annually on the FRC's budget to ensure it is adequate. Consult annually on the FRC's funding arrangements to ensure that the current voluntary arrangements continue to operate fairly and efficiently. There are reserve powers in Company Law to provide statutory levies.

None of these risks can be eliminated entirely because of the nature of the FRC's regulatory role and resources. The Board believes that the actions in place to address the risks are proportionate and should reduce their likelihood and/or impact.

The financial position of the FRC, including its cash flows and liquidity position, are shown in the financial statements on pages 57 to 60. In addition note 4 to the financial statements (page 65) describes the FRC's approach to managing financial risk.

Going Concern

The Directors believe that the FRC is well placed to manage its liquidity risks successfully. The FRC prepares an annual budget supported by regularly updated forecasts of both income and expenditure which are reviewed by the Board. Cash flow forecasts are prepared on a monthly basis. The FRC has continued to raise the funds it requires on the basis of non-statutory arrangements, supported by reserve powers to put the arrangements on a statutory basis. The flow of funds from the professional bodies, accounts preparers and other organisations has enabled the FRC to maintain reserves to meet unexpected costs arising from our regulatory role. Taking these factors into account the FRC is thereby in a position to apply the going concern basis of accounting in preparing the annual financial statements.

The FRC's operational effectiveness and financial security over the longer term will continue to rely on support from Government and Parliament for our role as the UK's independent regulator for corporate governance and reporting. The role of the FRC was reviewed and confirmed by Government in 2012; our powers were then extended. This year the EU has strengthened requirements for independent audit regulation and auditing standard setting and will require a single competent authority in each Member State for the purposes of audit regulation. The FRC acts as lead audit regulator within the UK and exercises considerable international influence: it is not expected that the new EU requirements will reduce the FRC's role and may increase it. There is continued governmental support for the further development of accounting standards at international level. Again this an area in which the FRC currently plays the leading role within the UK and would reasonably expect to continue to fulfil that role.

In making this assessment, the Directors recognise the authority of Government and Parliament in determining the FRC's future. The Directors believe that it is reasonable to operate on the basis that the FRC will continue to be the organisation asked to deliver its current responsibilities, recognising that regulatory arrangements inevitably evolve over time in response to changing circumstances.

3 – Financial Statements and Notes

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE FINANCIAL REPORTING COUNCIL LIMITED

Opinion on financial statements of The Financial Reporting Council Limited ("FRC")

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2014 and of its surplus for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

The financial statements comprise the Profit and Loss Account, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland.

Our assessment of risks of material misstatement

We identified the following risks of material misstatement that had the greatest effect on the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team:

Risk	Our response
Given the nature of the FRC's regulatory and disciplinary schemes, a risk arises in connection with the completeness and valuation of litigation cost provisions.	We tested the operating effectiveness of procedures and controls implemented by the FRC in respect of its regulatory activities and disciplinary schemes. We reviewed a sample of cases, specifically checking that the procedures and controls were being followed.
Revenue recognition, including the completeness of levy income.	We tested the operating effectiveness of procedures and controls implemented by the FRC and service organisations engaged by it in respect of revenue recognition. We reviewed the recognition of income around the year-end.
There is a risk of inappropriate allocation of personnel and other expenditure between core operating costs, audit quality review costs and disciplinary case costs which may result in the overstatement of income (due to	We reviewed the systems used to allocate costs incurred by the FRC between the costs of running disciplinary cases and its other activities. We tested a sample of expenditure ensuring that costs incurred have been

incorrect recharges to the relevant participant).	appropriately allocated and if appropriate, correctly recharged to the relevant participant.

Our application of materiality

We define materiality as the magnitude of misstatement that could reasonably be expected to influence the readers and the economic decisions of the users of the financial statements. We use materiality both in planning our audit and in evaluating the results of our work.

We determined planning materiality for the company to be £280,000, which is 1% of total expenditure (gross of the case cost awards). Overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the company was 75% of materiality, namely £210,000.

We agreed to report to the Audit Committee all audit differences in excess of £14,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also reported to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the company and its environment, including internal control, and assessing the risks of material misstatement. We undertook an interim visit to evaluate the implications of the adoption of FRS 102 and the associated risks.

We obtained an understanding of how the company uses service organisations in its operations and evaluated the design and implementation of relevant controls at the company that relate to the services provided by service organisations. We visited the service organisation engaged by the FRC to collect the levy income from large private entities, public sector organisations and pension funds.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of the above.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an Auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

David Cox (Senior statutory auditor)
for and on behalf of haysmacintyre,
Statutory Auditor
26 Red Lion Square
London
WC1R 4AG

THE FINANCIAL REPORTING COUNCIL LIMITED

Profit and Loss account for the year ended 31 March 2014

	Note	**2013/14** £'000	2012/13 £'000
Revenue		**26,058**	25,431
Operating expenses	2	**(25,986)**	(25,504)
Operating profit		**72**	(73)
Interest receivable		**113**	159
Profit on ordinary activities before taxation		**185**	86
Tax on profit on ordinary activities		**(23)**	(32)
Profit on ordinary activities after taxation		**162**	54

THE FINANCIAL REPORTING COUNCIL LIMITED

Registered number: 2486368

Balance Sheet at 31 March 2014	Note	**31 March 2013/14 £'000**	31 March 2012/13 £'000
Fixed assets			
Intangible assets	5	**16**	109
Tangible assets	6	**1,176**	647
		1,192	756
Current assets			
Debtors	7	**4,142**	3,429
Current asset investments	8	**5,900**	5,500
Cash at bank and in hand	8	**3,954**	2,990
		13,996	11,919
Creditors – amounts falling due within one year	9	**(6,500)**	(4,681)
Net current assets		**7,496**	7,238
Total assets less current liabilities		**8,688**	7,994
Creditors – amounts falling due after more than one year	10	**(974)**	(124)
Provisions for liabilities	11	**-**	(318)
Net Assets		**7,714**	7,552
Capital and reserves			
Accounting, auditing and corporate governance:			
-General reserve		**2,563**	2,663
-Corporate reporting review legal costs fund		**2,000**	2,000
Actuarial standards and regulation:			
-General reserve		**1,151**	889
-Case costs fund		**2,000**	2,000
		7,714	7,552

The financial statements on pages 57 to 60 were approved by the Board of Directors on 2 July 2014 and were signed on its behalf by:

Sir Winfried Bischoff

Chairman

THE FINANCIAL REPORTING COUNCIL LIMITED

Statement of Changes in Equity for the year ended 31 March 2014

	Accounting, auditing and corporate governance		Actuarial standards and regulation		
	General reserve	Corporate reporting review legal cost fund	General reserve	Case cost fund	Total
	£'000	£'000	£'000	£'000	£'000
At 31 March 2013	2,663	2,000	889	2,000	7,552
(loss)/ profit for the year	(100)	-	262	-	162
At 31 March 2014	2,563	2,000	1,151	2,000	7,714

Cash Flow Statement for the year ended 31 March 2014

	Note	**2014/14**	2012/13
		£'000	£'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated/ (absorbed) by operations	13	**1,315**	(471)
Corporation tax paid		**(32)**	(21)
Total cash inflow/ (outflow) from operating activities		**1,283**	(492)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of tangible assets		**-**	(319)
Current asset investments		**(400)**	(3,500)
Interest received		**81**	126
Total cash outflow from investing activities		**(319)**	(3,693)
NET INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS		**964**	(4,185)
Cash and cash equivalents at 1 April	8	**2,990**	7,175
CASH AND CASH EQUIVALENTS AT 31 MARCH	8	**3,954**	2,990

The notes on pages 61-71 form part of these financial statements.

1. Accounting policies

The Financial Reporting Council Limited (the FRC) is a company limited by guarantee, incorporated in the United Kingdom, and its registered office is 8th floor, 125 London Wall, London, EC2Y 2AS.

The following accounting policies which have been applied consistently in dealing with items are considered material in relation to the FRC.

a) Basis of Preparation

These financial statements for the year ended 31 March 2014 are the first financial statements of the FRC following adoption of FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland. The date of transition to FRS 102 was 1 April 2013. The FRC reported previously under the EU - adopted International Financial Reporting Standards (IFRS). The transition from IFRS to FRS 102 has not affected its reported financial position or financial performance. It has resulted in a reduction in the volume of disclosures.

These financial statements are prepared on an historical cost basis.

The preparation of financial statements requires the use of estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Although these estimates and associated assumptions are based on historical experience and the management's best knowledge of current events and actions, the actual results may ultimately differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis.

A significant level of judgement and estimation is typically required to determine the level of provisioning for dilapidation costs and litigation costs. The FRC relocated offices in June 2014 and dilapidation costs for the vacated premises have been negotiated and agreed.

b) Presentation of Financial Statements

Consolidated accounts are not prepared because the FRC's former subsidiary Accountancy & Actuarial Discipline Board Limited ceased trading at the beginning of the year. The preceding year comparative results remain the same and reflect the incorporation of Accountancy & Actuarial Discipline Board Limited into the parent company.

The presentational and functional currency is the British Pound Sterling.

c) Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable. The FRC has a variety of sources of revenue and accounts for them as described below:

- Revenue in respect of levies is accounted for on a receipts basis, as they are voluntary contributions.
- In earlier periods the FRC received Government grants for capital purposes. The FRC has applied the accrual method of accounting for these capital grants and the grants are being amortised over the useful economic life of the assets which they were used to purchase.
- The following revenue is received from participants to fund specific activities:
  - Revenue receivable from the ICAEW in respect of Audit Quality Review costs is recognised as the costs to be recovered are incurred in each financial year.

- Revenue receivable from various professional accounting bodies in respect of Accountancy disciplinary case costs is recognised as the costs to be reimbursed are incurred in each financial year.

- Revenue in respect of publications of various books, guidelines and standards are recognised on sale of goods or delivery of services.

- Revenue in respect of professional fee income relating to third country audit, the National Audit Office, the Audit Commission and Crown dependencies is recognised on an accrual basis as services are performed.

- A new source of income has arisen in respect of the recovery of XBRL taxonomy development costs. Revenue receivable in respect of XBRL costs is recognised as the costs to be reimbursed in each financial year.

d) Tangible and Intangible assets

Depreciation is provided on all property, plant and equipment and amortisation is provided on all software at rates calculated to write off the cost, less estimated residual value, over their expected useful lives on a straight line basis, as follows:

Tangible assets	
Office equipment	3 Years
Fixtures, fittings & furniture	10 years
Leasehold improvements	Lease term
Intangible assets	
Capitalised software	3 Years

e) Financial Instruments

Financial assets and financial liabilities are recognised when the FRC becomes a party to the contractual provisions of the financial instrument.

Cash and cash equivalents

These comprise cash at bank and other short-term highly liquid bank deposits with an original maturity of three months or less.

Current asset investments

These comprise bank deposits with an original maturity of more than three months but less than one year.

Debtors

Debtors do not carry any interest and are stated at their nominal value. Appropriate allowances for estimated irrecoverable amounts are recognised in the Profit and Loss account when there is objective evidence that the asset is impaired.

Trade creditors

Trade creditors are not interest bearing and are stated at their nominal value.

f) Case Costs and Fines

Case costs

The legal and professional costs of accountancy and actuarial disciplinary cases and Corporate Reporting Review cases incurred in the period are included in the accounts on an accruals basis. Provision is made for the future costs of any disciplinary cases only where the contract is onerous; the costs are unavoidable and represent a present obligation under FRS 102 at the Balance sheet date.

Fines and Cost awards receivable

In previous years when fines and costs awards had been received, these were not included in our financial statements and were passed directly to the relevant participating professional body. For the purposes of these accounts, case costs awards receivable in respect of accountancy disciplinary cases which are due to the relevant participant body under the Accountancy Scheme are included in the income statement of the FRC as a reduction to case costs incurred. Fines continue to be excluded from the financial statements.

Fines receivable and case costs awards in respect of actuarial disciplinary cases are retained and included within revenue in the period in which the fines and case costs become due and collectable.

g) Costs Funds

The FRC has two costs funds: The Corporate Reporting Review Legal Costs Fund and the Actuarial Case Costs Fund.

Contributions have been received from Government to enable the Conduct Committee to take steps to pursue compliance with the requirements of the Companies Act 2006 and applicable accounting standards and to investigate departures from those standards and requirements. Those funds may be used only for this purpose and may not be used to meet other costs incurred by the FRC. The FRC may be liable to repay the balance on the Legal Costs Fund to the contributors if it ceases to be authorised by the Secretary of State for the Department of Business, Innovation and Skills (BIS) for the purposes of section 456 of the Companies Act 2006. The Legal Costs Fund is currently maintained at £2m and BIS will reimburse the Fund to that level should the Fund usage reduce the balance to below £1m.

The Actuarial Case Costs Fund is built up by contributions received from the Actuarial Profession and through levies and is used to fund investigations into potential misconduct by actuaries and any related prosecutions.

2. Operating Expenses

	2013/14	2012/13
	£'000	£'000
Staff and related people costs (note 3)	**16,071**	14,632
IT and facility costs	**2,064**	1,896
Depreciation and amortisation costs	**607**	334
Auditor's remuneration:		
- audit	**43**	40
- non - audit services	**-**	-
XBRL taxonomy development costs	**1,300**	-
Accountancy and actuarial case costs	**3,323**	6,182
Other operating expenses	**2,578**	2,420
Total operating expenses	**25,986**	25,504

The accountancy and actuarial case costs are stated after deduction of costs awards of £2.25m.

3. Staff and related people costs (including directors)

	2013/14	2012/13
	£'000	£'000
Permanent staff:		
Salaries	**11,525**	10,312
Social security costs	**1,448**	1,280
Other pension costs	**1,221**	1,172
Total permanent staff costs	**14,194**	12,764
Other people related costs:		
Seconded staff and contractors	**209**	321
Fees to Board, Committee and Council members	**1,392**	1,309
Other costs	**276**	238
Total staff and related people costs	**16,071**	14,632

The average number of permanent staff employed in the financial year was 120 (2012/13: 114) in total. Of this the average number of persons so employed under: accounting, auditing and corporate governance including audit quality review and accountancy disciplinary cases was 114 (2012/13: 106) and actuarial standards and regulation was 6 (2012/13: 8).

The FRC does not operate a pension scheme. Other pension costs comprise payments to personal pension schemes.

Directors' emoluments

	2013/14	2012/13
	£'000	£'000
Fees (included in staff costs)	**1,752**	1,579
Other pension costs	**92**	76
Total directors emoluments (see page 47)	**1,844**	1,655
Social security costs	**218**	197
	2,062	1,852

Details of the emoluments of the directors are contained in the Directors' Report on page 46 - 47.

4. Financial risk management

The FRC's operations expose it to some financial risks. Management continuously monitors these risks with a view to protecting the FRC against the potential adverse effects of these financial risks. There has been no significant change in these financial risks since the prior year.

Financial instruments

The FRC's basic financial instruments in both years comprise cash at bank and in hand, current investments, loans debtors and creditors that arise directly from its operations.

The financial instruments hold surplus funds to fund future operating costs including case costs. The FRC has no gearing or other financial liabilities apart from creditors. The FRC's policy that no trading in derivative financial instruments shall be undertaken has been kept under review throughout the year.

Credit Risk

It is the FRC's policy to assess its trade receivables for recoverability on an individual basis and to make provisions where considered necessary. In assessing recoverability the management takes into account any indicators of impairment up until the reporting date.

The trade debtors were not impaired; hence no impairment losses have been recognised.

Depositing funds with commercial banks exposes the FRC to counter-party credit risk. The amounts held at banks at the year-end were with banks with solid investment grade credit ratings. To reduce the risk of loss, the bank deposits are spread across a range of major UK banks.

Interest rate risk

The FRC invests the majority of its surplus funds in highly liquid short term deposits with an original maturity no greater than eighteen months. The average interest rate on short term deposits is 1.2% (2013: 1.33%) and none of the deposits have an original maturity of more than one year at the balance sheet date.

Liquidity risk

The FRC maintains sufficient levels of cash and cash equivalents and manages its working capital by carefully reviewing forecasts on a regular basis to determine the requirements for its day-to-day operations.

5. Intangible Assets

	Software
	£'000
Cost at 1 April 2013	278
Additions	-
Cost at 31 March 2014	278
Amortisation at 1 April 2013	169
Charge for year	93
Amortisation at 31 March 2014	262
Net book value at 31 March 2014	16
Net book value at 31 March 2013	109

6. Tangible Assets

	Leasehold improvements	Office equipment	Fixtures, fittings and furniture	Total
	£'000	£'000	£'000	£'000
Cost at 1 April 2013	699	1,458	867	3,024
Additions	1,029	13	-	1,042
Disposals	-	(3)	-	(3)
Cost at 31 March 2014	1,728	1,468	867	4,063
Depreciation at 1 April 201	602	1,301	474	2,377
Charge for year	97	113	303	513
Disposals	-	(3)	-	(3)
Depreciation at 31 March 2014	699	1,411	777	2,887
Net book value at 31 March 2014	**1,029**	**57**	**90**	**1,176**
Net book value at 31 March 2013	97	157	393	647

7. Trade Debtors

	2013/14	2012/13
	£'000	£'000
Trade debtors	**529**	319
Prepayments	**623**	617
Accrued income	**1,720**	2,186
Other debtors	**1,270**	307
	4,142	3,429

Accrued income represents amounts receivable from the accountancy professional bodies in respect of accountancy disciplinary case costs. This amount is invoiced and received after the year end.

8. Cash and Investments Held

	Cash 2014 £'000	Deposits 2014 £'000	Total 2014 £'000	Cash 2013 £'000	Deposits 2013 £'000	Total 2013 £'000
Actuarial Case Costs Fund	-	2,000	2,000	-	2,000	2,000
Corporate Reporting Review Legal Costs Fund	2,000	-	2,000	-	2,000	2,000
General Accounts	1,954	3,900	5,854	2,990	1,500	4,490
Totals at 31st March 2014	**3,954**	**5,900**	**9,854**	2,990	5,500	8,490

Cash at bank and in hand represent cash and cash equivalents and the deposits represent current asset investments.

9. Creditors – Amounts falling due within one year

	2013/14	2012/13
	£'000	£'000
Trade creditors	**1,011**	216
Other taxation and social security	**1,069**	775
Accruals	**2,355**	2,919
Deferred income	**1,008**	443
Deferred lease incentive	**83**	-
Other payables	**951**	296
	6,477	4,649
Corporation Tax at an effective rate of 20% (2012/13: 20%) income of £113,000 (2012/13: £159,000).	**23**	32
	6,500	4,681

10. Creditors – Amounts falling due after more than one year

	2013/14	2012/13
	£'000	£'000
Accruals	**143**	43
Deferred income	**-**	81
Deferred lease incentive	**831**	-
	974	124

11. Provisions for Liabilities

	2013/14	2012/13
Leasehold improvements and dilapidations	**£'000**	£'000
Balance at 31 March 2013	**318**	294
Amount accrued transferred to creditors	**(48)**	-
Amount (released from)/ charged to Profit and Loss account	**(270)**	24
Balance at 31 March 2014	**-**	318

12. Significant transactions with other standard setters

The FRC raises the UK contribution to the funding of the International Accounting Standards Board (IASB) by issuing invoices and collecting monies on its behalf. The FRC does not make a charge for providing this service. The amount of monies collected during the year was £885,000 (2012/13: £860,000), of which £50,000 (2012/13: £65,000) remained to be paid over by the FRC to the IASB as at 31 March 2014.

13. Cash flow statement – cash generated from operations

	2013/14	2012/13
	£'000	£'000
Profit on ordinary activities before taxation	**185**	86
Adjustments for:		
- Interest income	**(113)**	(159)
- Depreciation and amortisation	**607**	334
- Release of dilapidation provision	**(318)**	24
- (Increase) in trade and other debtors	**(713)**	(874)
- Increase in trade and other creditors	**1,667**	118
Net cash inflow/(outflow) from operations	**1,315**	(471)

14. Commitments

On 31 March 2014, the FRC took out a lease for offices at 125 London Wall, and moved to those premises in June 2014. Contracts were also signed in relation to fit out and other relocation costs resulting in capital commitments of £1,840k at 31 March 2014 (2013: nil).

Total commitments for FRC under operating leases relating to the leasehold property for each of the following periods were as follows:

			2013/14	2012/13
	London Wall	Aldwych & Brussels	**Total**	Aldwych & Brussels
	£'000	£'000	**£'000**	£'000
Payments due within one year	**736**	**166**	**902**	453
Payments due within two to five years	**2,947**	**-**	**2,947**	160
Payments due after more than five years	**4,402**	**-**	**4,402**	-
	8,085	**166**	**8,251**	613

Total commitments for the FRC under operating leases for office equipment were as follows:

	2013/14	2012/13
	£'000	£'000
Payments due within one year	**9**	9
Payments due within two to five years	**11**	20
	20	29

15. Related party transactions

Key Management Compensation

The Directors represent key management personnel for the purposes of the FRC's related party disclosure reporting and their compensation is as disclosed in note 3.

Transactions with related parties

The related party transactions are transacted in the normal course of business.

16. Liability of members

The members of the FRC have undertaken to contribute a sum not exceeding £1 each to meet the liabilities of the Company if it should be wound up.

4 - Directors report

Directors

We have included information on the names of the persons who, at any time during the financial year, were directors of the company at page 33.

Under the terms of the FRC's Articles of Association, all Directors are members of the FRC and each has undertaken to guarantee the liability of the FRC up to an amount not exceeding £1. There are no other members and no dividend is payable.

Directors' insurance and indemnities

The Company purchased and maintained throughout the financial year Directors' and Officers' liability insurance in respect of itself and for its Directors and Officers. This gives appropriate cover for any legal action brought against the Company or its Directors or Officers.

Information on the following matters can be found in other parts of the Annual Report and Financial Statements

The FRC's financial risk management policy – pages 65

Important events affecting the company since the end of the financial year – pages 11 - 13

Likely future developments in the business of the company – pages 19 - 20

Activities in the field of research and development – pages 21 - 22

Disclosure to the auditor

The Directors, at the date of this report, confirm that, as far as each Director is aware, there is no relevant audit information of which the FRC's auditor is unaware. Each Director has taken all steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the FRC's auditor is aware of that information.

Fair and understanding

The Directors consider that this annual report is fair, balanced and understandable and the information necessary for the user to assess the performance and prospects of the FRC.

by order of the Board

Anne McArthur

Company Secretary

2 July 2014

Appendix

Audit Regulation - Delivering our statutory responsibilities

This Appendix reports on:

(i) the FRC's statutory oversight of the regulation of auditors by recognised professional bodies in 2013/14;

(ii) the FRC's statutory responsibilities as the Independent Supervisor of Auditors General;

(iii) the FRC's other oversight responsibilities.

1. SUMMARY

1.1. Our work focuses on specific areas each year. In 2013/14 our focus was on the approval of individuals able to take responsibility for an audit, on the initial handling of complaints and on the follow up of actions taken by the bodies in response to our previous recommendations, many of which refer to audit monitoring. Accordingly we may not identify all errors and weaknesses in each body's systems and procedures for audit regulation. Equally in a report such as this the emphasis is naturally on aspects of regulatory activity at the recognised bodies that give us specific concerns.

1.2. Against this background, our principal conclusions are:

- We see no reason at present to withdraw recognition from any recognised body.
- We found that staff at the bodies consider the approval of individuals within a firm able to take responsibility for an audit in compliance with each body's regulations and procedures. However, we consider that there is room to strengthen these procedures by improving further the assessment of applicants' audit experience to underpin a consistent and effective assessment process. This is an important area. In our view, the bar to obtaining such recognition should be a high one, as individuals must be competent to conduct audit work and have recent and sufficient relevant experience.
- In the case of the Association of Chartered Certified Accountants (ACCA) the weaknesses in the process for awarding their Practising Certificate with Audit (PCAQ) were more serious. The FRC issued a notice of proposed direction under section 1225B of the Companies Act 2006, to ensure that effective steps were taken to prevent any reoccurrence of the failures. It concluded that it was not necessary to give a formal direction under section 1225A, in view of the action taken by the ACCA and the undertakings it gave to commission an external review of its processes and practices in relation to the award of the PCAQ.
- We are pleased to confirm, in the light of our concerns over several years, that Chartered Accountants Ireland (CAI), through its regulatory arm, CARB, has met its UK statutory obligation to inspect all audit firms undertaking audit work in the UK at least once in the six years from April 2008.

- In our view too many firms continue to receive an unsatisfactory grading for their audit work following an inspection by their body. Each of the bodies has recently completed a 3 year plan to improve audit quality within their firms. The next stage will be to see how we can encourage the bodies to build on the improvements they have already achieved.

- Overall the bodies have responded positively to recommendations made in our previous reports. However, some recommendations involve change over the longer term, or have prompted bodies to carry out their own more extensive review of their own processes. It often takes some time before the recommendations of such a review are known. That said there are examples where progress has been slower than we expected.

- Our review of the way in which the bodies carry out their initial assessment of complaints found that the bodies take care over the handling of complaints and the treatment of both complainants and members of RSBs. However, we continue to find lengthy delays in some of the cases we review and have made recommendations to some bodies that they should improve their use of case management systems to monitor staff caseloads and ensure that target timescales are being met.

- We are taking forward a thematic review across all the RQBs on the practical training of statutory auditors, though it is too early to draw conclusions.

- The Comptroller and Auditor General (C&AG) continued to meet all his statutory obligations in respect of his role as a statutory auditor of companies under the 2006 Act.

(i) Statutory Oversight of the Regulation of Auditors

2. INTRODUCTION: MONITORING OF RECOGNISED SUPERVISORY BODIES AND RECOGNISED QUALIFYING BODIES

2.1. Section 1252(10) of, and paragraph 10(3) of Schedule 13 to, the Companies Act 2006 (the Act), require the FRC to report once in each calendar year to the Secretary of State on the discharge of the powers and responsibilities delegated to the FRC under sections 1252 and 1253 of the Companies Act 2006. In essence these responsibilities are to oversee the regulation of statutory auditors by Recognised Supervisory Bodies (RSBs) and the award of the statutory audit qualification by Recognised Qualifying Bodies (RQBs).

2.2. The FRC has the following graduated range of enforcement powers:

- To direct an RSB or RQB to take specific steps to meet its statutory obligations.
- To seek a High Court order requiring the RQB or RSB to take specific steps to secure compliance with a statutory obligation.
- To impose a financial penalty on an RSB or RQB where it has not met a requirement or obligation on it.
- To revoke the recognition of the RSB or RQB, following due process, where it appears to us that a body has failed to meet an obligation under the Act.

2.3. These powers enable us to address both serious and lesser failures by the recognised bodies and we consider that knowledge of the existence of these powers in itself further encourages timely responses by RSBs and RQBs to our recommendations.

2.4. Audit firms that wish to be appointed as a statutory auditor in the UK must be registered with, and supervised by, a Recognised Supervisory Body (RSB). Individuals responsible for audit at registered firms must hold an audit qualification from a Recognised Qualifying Body (RQB).

2.5. The following are both RSBs and RQBs:

- Association of Chartered Certified Accountants (ACCA)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Chartered Accountants Ireland (CAI)[1]
- Institute of Chartered Accountants of Scotland (ICAS)

2.6. In addition[2]:

- Association of Authorised Public Accountants (AAPA) is an RSB[3]
- Association of International Accountants (AIA) is an RQB

2.7. We exercise oversight primarily by:

- Documenting and understanding how each body meets all the statutory requirements for continued recognition, and making recommendations;
- Reviewing and testing the way in which each body's regulatory systems operate in practice, and making recommendations;
- Evaluating the effectiveness of specific aspects of the regulatory system across all the bodies;
- Keeping in regular contact with each body in order to discuss current issues and trends and future developments, for example proposed changes to a body's bye-laws or rules.

3. 2013/14 OVERSIGHT AND MONITORING

3.1. We carried out annual monitoring visits to each RSB in 2013/14. The objective of these visits is to test how the RSBs have applied regulatory requirements in practice in one or more specific areas. Most such visits consist of five days' fieldwork at the recognised body involving two staff members. During our visits we also reviewed the bodies' responses to recommendations made in prior years and carried out testing to confirm that the changes that had been made by the bodies were effective in addressing the issues we had raised in our previous reports.

3.2. We carried out shorter monitoring visits of two to three days to those RQBs where there were significant recommendations raised in previous reports that we wished to follow up.

3.3. We did not carry out a monitoring visit in 2013 to the AIA. This was for two reasons. First, we wished to give the AIA time to implement its action plan which addresses the recommendations of the expert review completed in May 2013 of AIA's statutory audit qualification and, secondly, the number of students studying for AIA's RPQ remains small. Nevertheless, we plan to visit the AIA in 2014/15 to ensure that it continues to meet the requirements for a RQB.

3.4. We also reviewed and approved 14 reports in 2013/14 of inspections of smaller auditors of

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[1] The Chartered Accountants Regulatory Board (CARB) carries out all the functions of the CAI as an RSB, in accordance with the CAI Bye-laws.

[2] The Chartered Institute of Public Finance and Accountancy (CIPFA) was recognised as an RQB in 2005, subject to conditions, but did not at that time develop fully the examinations and arrangements for practical training needed for the award of the statutory auditor qualification. CIPFA's RQB status is therefore in abeyance and we did not carry out a monitoring visit in relation to statutory audit in 2013/14.

[3] The AAPA, which was formed in 1978 to represent auditors individually authorised by the then DTI, was recognised as an RSB in 1991 following the Companies Act 1989. It became a subsidiary of the ACCA in 1996, since when its members have been supervised by the ACCA. We therefore reviewed the AAPA's regulatory responsibilities as part of our review of the ACCA. The AAPA had 39 firms registered as statutory auditors, as at 31 December 2013

public interest entities undertaken by the RSBs. This was in support of our responsibilities to approve the inspection methodologies and the assignment of inspectors to undertake this work; and to review the RSB's inspection reports on each firm.

3.5. We need good information to carry out this role. Each RSB and RQB provides an annual regulatory report, which includes statistical information on their regulatory activities during the previous year. Since 2012 we have also asked bodies to provide us with an annual Regulatory Plan, covering both RQB and RSB requirements.

3.6. In addition:

- We held meetings with each body to understand their key risks and future plans, as well as to discuss the findings and recommendations arising from our monitoring work;
- There were discussions between the Chief Executive and senior staff of the chartered accountancy bodies and the FRC's Conduct Committee about their regulatory strategy and plans; and
- Each body is expected to inform us of urgent or emerging significant issues relevant to their role as an RSB/RQB as soon as they arise, with a view to ensuring that our views are taken fully into account before decisions are taken.

3.7. We focused our 2013/14 RSB visits on:

- The processes and practice in respect of the registration of statutory auditors. The processes and practice of ICAEW, ICAS and CAI relate to the award of "responsible individual" (RI) status to individuals responsible for statutory audit work on behalf of a firm. ACCA applies distinct processes and practice and awards its practising certificate with audit qualification (PCAQ) to eligible individuals who wish to be able to sign audit reports on behalf of a registered audit firm. We reviewed the files for a sample of applications where RI status or a PCAQ had been awarded during the period from late 2012 to early 2014.

- The processes and practice in respect of complaints, in particular the handling of complaints closed by the Head of Investigations or equivalent after initial assessment and without the complaint being considered by a RSB's Investigation Committee, Complaints Committee or Independent Assessor. We reviewed the files and case papers for a sample of such complaints cases that were closed during 2012 and 2013.

- The progress made by the bodies in implementing our recommendations made in prior years. Many of these recommendations related to audit monitoring.

We report on this work in Section 4 below.

3.8. In addition to our follow-up visits to the RQBs we started a thematic review across all the RQBs focusing on the practical training of statutory auditors. We report on this in Section 6 below.

4. RESULTS OF 2013/14 RSB MONITORING – MAIN POINTS

4.1. Where appropriate we refer in this report to the individual bodies to which significant findings and recommendations apply. However, we invite all the bodies to consider the relevance of our findings to their situation. We also look carefully at the manner and speed with which individual bodies have responded to our previous recommendations.

4.2. All the bodies devote substantial resources to their regulatory responsibilities. We continue to see much regulatory practice of a high standard and in most cases our recommendations are aimed at encouraging the bodies to adopt best practice or to raise standards rather than at correcting major failings. As we have now been monitoring the statutory audit regulation for some ten years, we are able to see whether each individual body has sustained the improvements it has made and to focus on those areas where we have made repeated recommendations over several years.

4.3. The main points, from our 2013/14 RSB monitoring work in relation to each body are as follows:

ICAEW

- We found that the handling of RI applications required some improvement in terms of making amendments to the application form, obtaining additional information from applicants, the training and guidance of the staff who assess the applications, and ensuring that there is adequate documentation of the basis on which decisions to grant RI status have been reached.

- We found some delays in assessing complaints. Since our review ICAEW has amended its assessment process for more complex cases in order that the assessment is carried out by staff with the necessary expert knowledge and experience to deal with the matter efficiently;

- There were improvements in the processes for audit monitoring, specifically in documentation of reviewers' justification for the areas they had selected for review. We also found improvements in the quality of ICAEW's own internal management reporting of its audit monitoring

ACCA

- We reviewed a sample of applications for a practising certificate with audit (PCAQ). Our purpose was to follow up how ACCA had implemented measures in response to recommendations we had made in previous years and to obtain further evidence to confirm that ACCA is granting applications appropriately. We were disappointed to find cases in our sample where the PCAQ had been awarded to individuals who did not meet ACCA's requirements. The main reason for this was that ACCA staff were unable to correctly apply the rules, as they apply to complex cases. We also found that the verification of the audit experience of applicants for the PCAQ was weak, in some cases because ACCA staff were unable to identify when information received from applicants was incomplete, and because they lacked the background knowledge of audit work required to assess the nature and quality of the audit experience. These failings in the award of the PCAQ led the FRC Board to consider whether it might be necessary to issue a direction to the ACCA under our enforcement powers. We report on this at paragraphs 4.4 to 4.8 below.

- We reported last year on the importance that we attached to the successful implementation of ACCA's case management system for complaints. We were pleased to see that most features of the new system had been brought into use in June 2013. However, the full implementation of the reporting function is not expected to be completed until the end of 2014. We attach considerable importance to the reporting function as a management tool to improve the management of cases and workloads, given that there have in the past been unacceptable delays in the handling of some complaints. Since our review ACCA has made significant changes to the management and organisation of its complaints and investigation functions.

- We reviewed a sample of audit monitoring visits focused on inspections of firms that had previously had more than one poor visit outcome. We consider that the actions recommended by ACCA's Practice Monitoring staff were consistent and appropriate. We continue to monitor a number of pilot studies intended to identify what measures are most effective in bringing about substantial improvement to the quality of these firms' audit work;

ICAS

- We made a small number of recommendations regarding how ICAS processes applications for RI status. These address similar points to those we found at other RSBs and cover the application form, the nature of the information that applicants should be required to provide when describing their audit experience and the documentation of the basis on which decisions to grant RI status have been reached. ICAS had itself identified some of these areas for improvement prior to our visit and we were therefore able to reach agreement quickly on the changes that were needed;

- In respect of the complaints cases we reviewed in 2013 our overall conclusion was that they had been closed within a reasonable timescale and without undue delays. We found that the assessment of the complaints was properly documented and that both complainants and members had been treated in a considerate way;

CAI:

- We have queried over several years whether the Chartered Accountants Regulatory Board (CARB), the regulatory arm of Chartered Accountants Ireland, was deploying sufficient resources to meet its statutory obligation to monitor all its audit firms undertaking UK audits within six years of April 2008. We are pleased to report therefore that in early 2014 CARB achieved its objective of visiting all UK registered firms within a six year period. This is significant achievement for CARB given that it was necessary for many of its monitoring staff to work on a review of audits of major banks in Ireland over several years. CARB has confirmed that it will continue to monitor and manage its resources requirements closely to ensure that all planned quality assurance activities are completed within the required timescales and we expect to continue to monitor this area closely ourselves.

- We were also pleased to find that CARB had maintained the quality of its audit monitoring work and had been able to start to reduce the time taken between a visit and the issue of the audit monitoring report.

- As at other RSBs, we identified some areas where the processing of RI applications needs to be improved, so as to ensure that only those with the necessary skills and experience are able to sign audit reports.

- We found that there was an absence of management information on the time taken to close complaint cases and some features of CARB's current case management system had not been implemented on a systematic basis. We consider it most important that the new case management system, due in 2015 as part of a major IT project, is successfully implemented. CARB and CAI have based their responses to a number of our recommendations in recent years on the expectation that the issues would be properly addressed by its new IT systems.

Possible Enforcement Action

4.4. In considering the ACCA's failings in the award of their Practising Certificate with Audit (PCAQ) the FRC issued a notice of proposed direction to the ACCA, to ensure that effective steps were taken to prevent any reoccurrence of the failures. It concluded, in the light of the action taken by the ACCA, and the undertakings it gave, not to issue a formal direction. However, the Board noted that this had been a recurring area of concern in that in that the follow through to the implementation of FRC's past recommendations had not been as effective as it might have been and confirmed that it would take very seriously any repetition or failure in this or any other area..

4.5. The ACCA committed to:

- a second-review all new applications for the PCAQ by qualified accountants from the Audit Employers Team;
- Make changes to the application forms and associated processes to ensure there are no gaps in the information provided;
- Identify non-standard applications at an early stage and put additional checks in place for such cases;
- Re-reviewing all applications made since 1 January 2013 to check that awards have been made correctly.

4.6. We carried out a further inspection visit to ACCA in early May 2014 to review the measures taken by ACCA. Our main conclusions were:

- ACCA had carried out all the measures that it said it would do in response to our Report. The changes is has made should help considerably to prevent a reoccurrence of the failings, though it is too early to confirm that these are effective in practice.
- Their re-review of applications made since January 2013 confirmed that there had been serious weaknesses in the process that ACCA used to review PCAQ applications up to February 2014.
- We are satisfied that ACCA has either withdrawn the PCAQ (in the case of three members) or is taking appropriate steps to obtain additional information from its members and will withdraw the PCAQ from a member who does not meet the requirements.
- It was disappointing that we found a significant number of cases that the ACCA had re-reviewed, where we concluded that ACCA should have asked further questions to ensure that the PCAQ was correctly awarded.

4.7. The ACCA also reported to us in April a further issue relating to the award of their audit qualification. They discovered that they had incorrectly awarded exemptions to around 100 members (dating back to January 2010) from first level law and tax papers on the basis of a qualification acceptable for ACCA membership but not for the UK audit qualification. This resulted from an error in the way these exemptions were recorded on ACCA's database. Whilst most of these exemptions were given many years ago the effect was that the individuals were subsequently incorrectly awarded the PCAQ. ACCA has put in place a programme to support these individuals to complete one or both of the first level law and tax papers by December 2014. ACCA has also updated its approval processes to ensure that the UK law and tax requirements for the UK Audit Qualification have been met.

4.8. The FRC made clear that the failings related to the award of the PCAQ are unacceptable and set out the further steps it expects the ACCA to take. The ACCA and its Regulatory Board have reaffirmed their full commitment to ensuring that there is no repetition of these errors and have agreed to commission an external review of its processes and practices related to the award of the PCAQ

Other Issues

4.9. We report below on other regulatory issues that are relevant across all the RSBs.

Audit quality

4.10. In 2010/11 we asked each body to develop a three-year action plan for raising audit quality at the smaller audit firms, designed to identify the issues underlying the results of monitoring, and to set out the steps they would take to address them. We welcome the initiatives each body has taken initiatives to improve audit quality, over and above carrying out audit inspections. However, almost inevitably it is difficult to link such initiatives and specific improvements in audit quality, as the effects are indirect, take time and the population of firms visited each year is different. We plan to hold a meeting of all RSBs in 2014 to share and discuss the outcomes of the three year plans and to consider what further steps the RSBs might take. We are also reviewing audit monitoring at each of the bodies in 2014/15 with particular reference to the processes for preparing the visit report, completing the visit, agreeing any actions required to be taken by the firm and the subsequent follow-up of these actions by the body to ensure that they have been properly carried out.

Joint Audit Register

4.11. The Joint Audit Register (JAR) is a public record of registered audit firms and individuals eligible to sign audit reports on behalf of their firm. The JAR is maintained by ICAS on behalf of all the RSBs, and is updated on a weekly basis. At ICAEW, ICAS and CAI we found a small number of cases where individuals within our samples of RI applications had not been included correctly on the JAR. We recommended that each RSB should consider the accuracy of the information it sends to ICAS and to complete a reconciliation between its own database and the information on the JAR.

Complaints

4.12. Schedule 10 of the Companies Act 2006 requires RSBs to have effective arrangements for the investigation of complaints against persons who are eligible under its rules for appointment as a statutory auditor.

4.13. We focused in 2013/14 on complaints closed at an early stage of the complaints process. The process followed by each RSB differs but typically the complaints we reviewed had been closed after initial assessment or after conciliation. The decision to close is made by the Head of Investigation or Professional Conduct or equivalent with the complainant having the right to seek a review of that decision.

Overall we consider that the handling of these complaints cases has improved since our previous review of this area in 2009. We welcome the progress that has been made in reducing the time taken to close complaints. However, there continue to be some unnecessary delays at ICAEW and CAI in the handling of complaints, and consider that they need to refine and improve the use of existing case management systems to review the progress of cases. We have recommended to ACCA that the reporting module of its new case management system be implemented as soon as possible, to assist with the management of staff workloads and of delays.

4.14. More generally, we recognise that there are significant differences between the professional bodies' approach to complaints and discipline and that adopted by the FRC's Professional Discipline function in respect of cases which raise important issues affecting the public interest in the UK. In most respects these differences are appropriate given the scale and complexity of the cases dealt with by the bodies and the FRC respectively. Nevertheless, for those cases that are judged as close to the boundary for meeting the public interest test the question arises whether the differences of approach are justified. Partly for this reason we have instituted regular meetings with the ICAEW (which regulates most of the largest audit firms) over the past year to discuss how best to handle those cases which come close to the threshold for referral to the FRC. We are planning to look more closely at this issue in the coming year.

5. MAIN ISSUES IDENTIFIED AT THE RECOGNISED QUALIFYING BODIES (RQBS)

5.1. Our monitoring visits to the RQBs in 2013/14 were restricted to following up prior year recommendations. We report on that work in this section.

Prior year recommendations: exemptions or credit for prior learning

In 2013 we reviewed progress in implementing our recommendations at the ACCA on the award of credit for prior learning, more commonly known as exemptions. We looked at the ACCA's system, which applies to its students globally, though in only a small percentage of cases will the exemptions be relevant for UK statutory audit.

5.2. Based on our sample in 2013 we found that:

- ACCA has substantially increased the level of checks carried out on exemption applications, but these are not yet as effective as we might have hoped;
- ACCA needs to reduce further the error rate in relation to the award of exemptions;
- The time required to check exemption applications depends on the complexity of the application and the number of exemptions applied for. We consider that ACCA needs to maintain a greater focus on exemption applications from accountancy graduates of UK universities. This is because these graduates are often eligible for five or more exemptions, some of which have been awarded on the basis of passing a specific module within a specific degree course and because exemptions may be relevant to an individual's eligibility for the audit qualification.

5.3. We welcome the work being done by ACCA comparing the examination performance of different groups of students such as students with and without exemptions. Since our visit ACCA has made further changes to the nature and frequency of the checks that it makes on the processing of exemption applications and has reaffirmed its commitment to a further reduction in the number of processing errors as a result of these changes.

Prior year recommendations: practical training

5.4. In 2012/13 we reviewed a sample of practical training records at ICAEW, ICAS and CAI. We recommended that ICAEW and CAI should address the design limitations of their training records in respect of the recording of audit hours and enhance the functionality of their on-line systems in ways which lead and encourage students to complete records to a higher standard, and encourage firms to undertake regular reviews.

5.5. We were pleased to find that ICAEW had included a section in its new on-line training record system for students to record the number of days of UK statutory audit experience and the number of days of work similar to UK statutory audit experience. At the time of our visit it was too early for us to see how students and firms will use the new on-line system in practice.

5.6. In 2012/13 we made a number of recommendations directed at improving the way in which audit experience is recorded in CAI's "CA Diary" system. CAI took immediate steps, such as issuing additional guidance and writing to all training partners and students, to highlight the issues that should be addressed by both students and mentors in completing and approving CA Diary records. In February 2014 we reviewed a further sample of CA Diaries but did not find any significant improvement in the quality of the entries or the reviews.

5.7 We accept that it will take time to achieve consistently high standards across all training firms and we are therefore leaving these recommendations open until we carry out a further review of this area. In particular CAI plans to make further improvements to the CA Diary system as part of its project to replace its IT systems in 2014/15. We have emphasised that we attach considerable importance to the successful implementation of this project and that regulatory requirements must be considered at the design stage.

6. PROJECT ON PRACTICAL TRAINING OF AUDITORS

6.1. We supplemented our RQB monitoring with a thematic review across all the bodies focusing primarily on the practical training of statutory auditors. This work is not yet complete and we report on progress to date.

6.2. This work should not be considered in isolation from our other statutory oversight work. We consider that the practical training of student auditors is the key foundation upon which more advanced skills are built. High quality practical training is the first part of the individual auditor's progression which moves through qualification and taking increasing levels of responsibility to the development of highly competent and experienced audit professionals, and to high quality audit work within registered audit firms.

We considered that practical training was a suitable subject for a thematic project because:

- We wished to take a more in-depth view of the policies and practices governing the practical training of auditors;

- We had concerns about whether the minimum period of practical training in statutory audit work and in other audit work remained sufficient. This has remained unchanged for many years but the demands on auditors have increased considerably during that period;

- We had raised concerns during RQB compliance visits about the recording and monitoring of student training by both students and firms;

- The Companies Act requirements are written in general terms and are open to differing interpretations. Some bodies have said that they are uncertain what interpretations of the Act we consider appropriate; we therefore wish to satisfy ourselves that the practical training requirements for auditors remain appropriate to meet the Companies Act requirements and to support the training of auditors that are able to undertake statutory audits of a high quality

6.3. To date we have :

- Analysed the responses from audit regulatory bodies in ten countries to a questionnaire on their arrangements for the practical training of auditors This covered matters such as length of training period, requirements for training records, the supervision and assessment of students and the approval of training offices..

- Discussed with four UK RQBs:
  - The strengths and weaknesses of each RQB's current practical training regime;
  - How the body monitors the availability and quality of practical training in audit work and the results of that monitoring;
  - How the body is responding to the increasing difficulty for some students in gaining sufficient practical audit experience;
  - The differences between pre and post membership (student and practising certificate development) training; and
  - Compared the requirements for the practical training of auditors and accountants with the requirements for trainee solicitors and actuaries.

6.4. Obtained the views of a substantial sample of recently qualified members and of a sample of mentors in training firms by means of an on-line questionnaire. We will also take into account the findings of a project commissioned jointly by the FRC and ICAS where work is currently in progress. One element of this project considers the mix of attributes, competencies, professional skills and qualities that need to be combined in an audit team.

6.5. We expect as a result of this work to set out what we consider to be best practice in this area, and, if we conclude that the current interpretations of the statutory requirements are no longer adequate, we will consider with the bodies what changes to the requirements should be made.

6.6. Whilst we have not yet reached final conclusions, nor discussed possible actions with the bodies, the following are emerging issues from our work to date:

- Whilst there is a case for increasing the minimum practical experience of audit required to obtain the audit qualification, some students already exceed the current requirement by a considerable margin. The practical effect of an increase would be mostly on students in some small and medium sized firms where the rise in the audit threshold has reduced the availability of audit work experience. One option would be to accompany any increase with greater flexibility in the definition of work that counts as audit work;
- The quality of practical training is at least as important as the quantity. Increasing the required number of audit days without also addressing the quality of the training is unlikely to bring about significant improvements. There has been only limited consideration by the bodies, by training firms and by training principals within firms about the factors that may improve the quality of training;
- The timing and progression of a student's audit experience is extremely important. It is likely to be beneficial if a substantial part of a student's audit experience is gained in the later part of a training contract rather than early in the training period. An increase in the length of the experience requirement might be helpful in encouraging this;
- The distinction in the Companies Act 2006 between time spent on "statutory audit work" and time spent on "other audit work similar to statutory audit work" is poorly understood by both students and firms and is poorly recorded in training records. Accordingly there is a

case for a review of the interpretations of "statutory audit work" and "other audit work", given that the core skills are the same for both statutory audit work and other audit work;

- The bodies consider that good quality audit training is available at both large and small firms. Smaller firms generally offer a broader range of experience to enable students to gain the competencies required for membership and this may include a greater exposure to non-audit work. Large firms are more formal and typically can offer a substantial amount of audit experience to students, though there is a danger that the nature of the audit work is concentrated in a narrow specialised field.

(ii) Report of the Independent Supervisor of Auditors General

7. INTRODUCTION

7.1. The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012 names the FRC as the Independent Supervisor of the Comptroller and Auditor General (C&AG) and the other Auditors General, in respect of their work as statutory auditors of companies under the Companies Act 2006 (2006 Act).

7.2. Section 1228 of the 2006 Act requires the Independent Supervisor to report on the discharge of its responsibilities at least once in each calendar year to the Secretary of State, the First Minister of Scotland, the First Minister and the Deputy First Minister in Northern Ireland, and to the First Minister for Wales. This report meets the statutory reporting requirements.

7.3. The Comptroller and Auditor General (C&AG) and the other Auditors General are eligible for appointment as the statutory auditors of companies under the 2006 Act, subject to meeting certain conditions.

7.4. One of those conditions is that an Auditor General is subject to oversight and monitoring by an "Independent Supervisor" in respect of statutory audit work. To date only the C&AG has entered into the necessary arrangements with the FRC and undertakes statutory audits under the 2006 Act. The year to 31 March 2013 was the fifth year in respect of which staff at the National Audit Office (NAO) undertook statutory audit work, auditing the accounts of 27 companies. This is a minor part of the NAO's work but enables the NAO to undertake the statutory audit of companies that are owned by Government Departments and other public bodies whose financial statements it audits. The responsibilities of the Independent Supervisor do not extend to the other work of the C&AG.

8. SUPERVISION ARRANGEMENTS

8.1. Section 1229 of the 2006 Act requires the Independent Supervisor to establish supervision arrangements with any Auditor General who wishes to undertake statutory audit work, for:

- Determining the ethical and technical standards to be applied by an Auditor General;
- Monitoring the performance of statutory Companies Act audits carried out by an Auditor General; and
- Investigating and taking disciplinary action in relation to any matter arising from the performance of a statutory audit by an Auditor General.

8.2. These supervision arrangements are set out in a Statement of Arrangements and Memorandum of Understanding (MOU) between the FRC and the C&AG, and include a requirement for the monitoring of the C&AG's statutory audit work by the FRC's Audit Quality Review (AQR) team, on behalf of the Independent Supervisor.

9. REPORTING REQUIREMENTS

9.1. We report below in accordance with the requirements of Part 4 Appointment of the Independent Supervisor, Article 19 (a) to (e), Article 20 and Article 21 of SI 2012/1741 Statutory Auditors (Amendments of Companies Act 2006 and Delegation of Functions etc.) Order 2012 which came into force on 2 July 2012.

(a) Discharge of Supervision Function

9.2. The supervision arrangements require that the C&AG and relevant NAO staff follow technical and ethical standards prescribed by the FRC when conducting statutory audits and sets out the investigation and disciplinary procedures that would apply were there a need to discipline the C&AG in his capacity as a statutory auditor. The relevant standards are those set by the FRC for auditors generally.

9.3. We meet periodically with senior staff responsible for the audit practice of the NAO on behalf of the C&AG. We have familiarised ourselves with the NAO procedures to discharge these responsibilities and keep abreast of any changes.

(b) Compliance by Auditors General with duties under 2006 Act

9.4. As noted above, to date only the C&AG has undertaken statutory audits, all of which have been of companies within the public sector.

9.5. The AQR inspection in 2013/14 of the C&AG's statutory audit work comprised:

- Updating its understanding of the processes and procedures supporting audit quality that applied to these audits; and
- Reviewing the performance of 2 of the 27 statutory audits carried out by NAO staff in respect of financial periods ending on 31 March 2013.

9.6. Progress has been made in addressing the prior year inspection findings. There are a limited number of areas where further action is required.

9.7. In respect of the individual audits reviewed the issues we identified were of less significance than in the prior year.

9.8. On the basis of the findings of the AQR, and subject to the NAO's action plan to deal with those findings, in our view the NAO has policies and procedures in place that are generally appropriate to the conduct of its Companies Act statutory audits.

9.9. We found no evidence that any Auditor General was in breach of duties under the 2006 Act.

(c) Notification by Auditors General under Section 1232 of the 2006 Act

9.10. No Auditor General was required to notify the Independent Supervisor of any other information under Section 1232 of the 2006 Act.

(d) Independent Supervisor's Enforcement Activity

9.11. We issued no enforcement notices and made no applications for compliance orders in 2012.

(e) Account of Activities relating to the Freedom of Information Act

9.12. We received no requests for information under the Freedom of Information Act in our role as the Independent Supervisor.

(iii) The FRC's other oversight responsibilities.

10. REGULATION OF THIRD COUNTRY AUDITORS

10.1. The European Union sets specific requirements for the regulation of the auditors ("third country auditors" or TCAs) of companies from outside the EU that issue securities traded on EU regulated markets. The FRC is responsible for applying these requirements, including monitoring the quality of a TCA's audit work in some circumstances where the firm is not separately subject to equivalent external monitoring. The issue is important because of there are some 200 issuers from 45 countries outside of the EU whose securities are traded on a UK regulated market.

10.2. Carrying out inspections of audit firms widely scattered across the world and with typically only one or two relevant audit clients poses legal and practical challenges in some jurisdictions, in particular local confidentiality laws can hinder access to audit working papers. We work hard to overcome these.

10.3. The FRC carried out inspections of three audits in 2013/14, one each at three TCAs, two in Kazakhstan and one in Bahrain. The quality of the audits we reviewed was comparable to the results of our reviews of audits of UK companies, with one audit graded as "Limited improvements required" and two as "Improvements required". We have published a separate report on this work and it is available on our web-site at https://www.frc.org.uk/Third-country-auditors.

10.4. It is important that investors understand the FRC's role and what we can and cannot do. This is explained in detail on our web-site.

11. LOCAL AUDIT AND ACCOUNTABILITY ACT 2014

11.1. This Act abolishes the Audit Commission and introduces new arrangements for the regulation in England of the auditors of the accounts of local authorities and some other public bodies. In essence the legislation makes parallel arrangements for local public audit to the regulatory arrangements in the Companies Act. The Government is expected to delegate responsibility for oversight of local audit regulation to the FRC, and expects the FRC to take principal responsibility for inspecting the quality of the audits of major local bodies.

11.2. The new regime will be implemented progressively from April 2015. We expect that the first audits to be inspected by the FRC under this structure will be those of accounts for 2016/17. We continue to work closely with the Department for Communities and Local Government and other interested parties to develop the detailed regulatory arrangements for a smooth transition to the new structure.

12. OVERSIGHT OF COMPLAINTS-HANDLING BY PROFESSIONAL ACCOUNTANCY BODIES

12.1. As part of its non-statutory oversight role the FRC considers complaints about the way in which the six chartered accountancy bodies handle complaints about their members. Over the year we reviewed a small number of individual complaints and also conducted broader reviews of the complaints and disciplinary arrangements at the Chartered Institute of

Management Accountants (CIMA) and the Chartered Institute of Public Finance and Accountancy (CIPFA).

12.2. Our review of CIMA's processes was timed to coincide with the creation by CIMA of a working group to oversee the body's internal review their processes in this area. We attended meetings of this group as an observer.

12.3. Our review identified a number of areas for improvement. Most of the issues had also been identified by CIMA's own working group and were subsequently built into the group's final report to CIMA's Council.

12.4. We also conducted a review of CIPFA's complaints and disciplinary arrangements. We found that CIPFA's processes appear to be robust and are capable of dealing effectively with complex investigations as well as more straightforward service complaints and conduct issues. CIPFA benefits from receiving a relatively small number of complaints which enables the staff there to consider each matter in detail.

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