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Dear Sir/Madam

**PwC Comments of the Financial Reporting Council's (FRC) Draft Plan and Budget for 2008/2009.**

We welcome the opportunity of commenting on the FRC's 2008/2009 draft plan and budget. We fully support the FRC's overall aim of promoting confidence in corporate reporting and governance in the UK, and agree with the FRC's assessment that this has been largely achieved.

Rather than address the specific questions asked in the consultation document, we have the following observations with respect to the FRC draft plan and budget.

**Defining the FRC's forward agenda**

The FRC is an important element of the overall regulatory structure in the UK, and critical to the reputation of the audit profession both here in the UK and overseas.

Determining the FRC's future agenda, and its short-term plans and budget, are therefore important components which, if got right, can enhance oversight of the profession and reinforce the important leadership role it has to play in creating an investor climate of trust throughout the world.

This context we believe to be of critical importance as we have some serious misgivings about the FRC's current direction of travel and certain specific agenda items which, rather than enhancing oversight and the reputation of the profession, appear, rightly or wrongly, to be undermining the profession's position both in a UK and a global context.

## **Accountability and transparency**

Government has recently signalled that it no longer intends to contribute one third of the FRC's budget, relying on market participants to pay the majority of the FRC's costs.

Whilst we realise that there will be a public consultation on future FRC funding, we consider that, with the removal of this "government lever", the FRC will need to consider what mechanisms are needed to ensure that its accountability and transparency are sufficient to maintain market participants' confidence in the regulatory process. One way in which confidence could be maintained is by the independent assessment of the cost and effectiveness of the FRC's work plan by the National Audit Office (an observation we make on the FRC Budget later in this response).

Clearly, in this regard, the FRC has the final say in determining its agenda. We believe, however, that in the long-term its effectiveness and value will in large part be determined by the quality of its engagement with its key stakeholders and its ability to create a truly collaborative regulatory model.

We would also suggest that the FRC will need to assess its future agenda and plans by considering the balance, more closely, of the costs and the benefits of its proposed programme – a test which the FRC does not appear to use at present. As an example, we fully support the FRC in its aim of promoting confidence in corporate reporting, but believe that an important element of that aim is the application of a rigorous test in assessing whether action is required, and whether any benefit which may be achieved is proportionate to the cost.

These comments will, we hope, put into context our more detailed observations on the draft plan and budget.

## **1. The Plan**

### **General Comments**

#### **(a) Presentation of plan**

We consider that the contents of the plan could have been presented in a more effective, logical and succinct way by combining the content of two documents, which cover nearly 60 pages. This would, we suggest, assist interested parties to focus on areas of particular interest. A product of this approach would have been a shorter clearer document, removing unnecessary duplication.

#### **(b) Regulatory tone and the calibration of performance**

The FRC proposes three tests to assess whether an outcome has been achieved – *largely achieved*, *significant concerns* and *serious shortcomings*. In all instances, there is no capacity for 'full achievement' as each definition has a rider that more could be done.

Whilst we support the principle that improvements should always be sought, we would refer to the statement on page 15 of the report that states:

*‘There is a risk that aspects of the current regulatory regime for corporate reporting and governance for which the FRC is responsible impose disproportionate costs on regulated entities. If this risk materialises we would have significant concerns about the achievement of this supporting outcome’.*

One of the results of setting a bar that can never be met is the potential imposition of disproportionate cost. Even more damaging is the effect this approach can have on business confidence in the UK’s ‘light touch’ regulation in corporate reporting, governance and auditing.

Whilst we accept that there is no room for complacency, a positive ‘tone from the top’ message from the FRC, that UK corporate reporting, governance and auditing systems are operating to a high level, will, we suggest, promote confidence.

One way in which this message could be relayed would be for the FRC to apply positive rather than negative tests to its outcomes.

**Outcome Two – Corporate Reporting (Page 12).**

There is an increasing call amongst stakeholders for the simplification of financial reporting. The removal of complexity, which results in reports that have little relevance to the majority of shareholders, has become the key area of concern in corporate reporting. It appears that this complexity has built up over a number of years from regulatory intervention resulting in a more rule based system of financial reporting.

This firm, along with others, has been at the forefront in seeking ways to make corporate reporting more relevant and reliable as we believe it is a major public policy issue at the heart of the effective working of the capital markets and the societies in which they operate.

In 2006, along with CIMA and RadleyYeldar (a communication consultancy firm), we started the Report Leadership project<sup>1</sup>. The aim of the project is to develop simple, practical yet effective ways to improve narrative and financial reporting.

To demonstrate how this could be done we published an annual report for a fictitious company, in November 2006, using a new reporting model<sup>2</sup>. This approach identified how companies could simplify their annual accounts. Since that time the group has published further advice aimed at assisting an improvement in executive remuneration reporting.

In December 2007, the Prince of Wales Trust project on Accounting for Sustainability also published its findings on reporting. This project, with which we were also actively involved, called for a recasting of the reporting model to recognise the convergence which is currently taking place between financial, corporate and sustainability reporting.

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<sup>1</sup> Link to website: [www.reportleadership.com](http://www.reportleadership.com)

<sup>2</sup> Link to document:

[www.reportleadership.com/files/page/608/GENERICO\\_RandA\\_07.pdf](http://www.reportleadership.com/files/page/608/GENERICO_RandA_07.pdf)

In January 2008, the CEOs of the six largest global accounting firms published a white paper on principles based accounting standards<sup>3</sup>. The paper was developed to promote debate on the issues that should be discussed and considered as the global capital markets move towards a single set of high-quality accounting standards (IFRS) based on principles and not rules. The approach adopted in this paper has been widely supported by stakeholders and standard setters.

We consider that the factors identified at Outcome Two are only part of the solution to providing relevant, reliable and understandable reports that underpin the importance of a true and fair view. We would urge the FRC to lead a debate in the UK, in which we would wish to play an active role, with the aim of simplifying financial reporting and enhancing corporate reporting.

### **Outcome Three – Auditing (page 13).**

In pursuit of the FRC's overall objective of 'promoting confidence in corporate reporting', we are surprised by two elements of paragraph (b) - 'Implementation'.

First, we suggest there are two unrelated areas that have been treated as related, namely, choice in the audit market and the ability of audit staff to audit appropriately entities affected by current credit market conditions.

#### **(a) Choice in the audit market**

From the supporting text it appears that the area of 'significant concern' (albeit that the text also states that 'there is an efficient market for audit services in the UK') is the level of concentration in the audit market.

In 2007, the Market Participants Group carried out extensive work on the area of choice in the audit market that resulted in a number of recommendations for companies, shareholders, auditors and the regulator to consider. However, there was recognition that any changes to the current position may not take effect until the medium or long term.

If the FRC considers that this is an area on which it wishes to expend resource, we suggest this is identified as a separate issue in the Plan so commentators can gauge whether this will be an effective use of resource.

#### **(b) Auditor competence**

We are concerned by the tone of the final paragraph on page 13. As previously identified, the role of the FRC is 'to promote confidence' and we consider that suggesting 'that auditors may not adequately address the risks arising from credit market conditions' does not promote confidence but rather calls into question the ability of auditors to perform independent audit in a professional way without any evidence to support such an allegation.

With the aim of promoting compliance with financial reporting standards, the 'Big 6 Accountancy firms' published, in December 2007, a paper titled 'Determining Fair Value of Financial Instruments under IFRS in Current Market Conditions'. The purpose of this paper was to assist preparers of financial reports by enhancing awareness of the requirements of International Financial Reporting Standards (IFRS) in relation to the determination of fair value of financial assets and financial liabilities and related disclosures in the context of current market conditions.

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<sup>3</sup> Link: [www.globalpublicpolicysymposium.com/GPPC\\_PBS\\_White\\_Paper.pdf](http://www.globalpublicpolicysymposium.com/GPPC_PBS_White_Paper.pdf)

Although there have been a number of problems within the financial sector this year, early indications are that these have been as a result of market conditions or rogue members of staff. To date, there is no evidence that auditors have failed to address the risks from current market conditions, and we would suggest that the FRC should be supporting the audit profession at this time rather than seeking to question its ability.

## **Outcome 6 – FRC Effectiveness (Page 20).**

We support the FRC's engagement with IFIAR (supporting outcome 6b) as important to ensure that the UK can influence global and regulatory organisations and authorities with the aim of achieving regulatory harmonisation so far as possible. However, IFIAR has not yet achieved the level of transparency that the FRC has and we consider it important that the FRC accurately reports on its IFIAR related costs, with respect to financial, staffing and other resources, so that a proper assessment of the cost and benefits of this organisation can take place.

## **2. The Budget**

We fully support the desire of the FRC to employ 'high quality people', and recognise that this may necessitate above inflation rises in the FRC's budget. However, the draft budget includes just three lines to justify this increase and we consider that more detail should be included.

The Financial Services Authority (FSA) 2008/09 Business plan<sup>4</sup> (pages 39 to 41) contains detailed information justifying a 4.5% increase in staff costs, and we would suggest the FRC may consider this a useful template.

On 6 February 2008, Gareth Thomas (the Parliamentary under Secretary of State for Trade and Consumer Affairs) announced in a written statement that the Government had concluded that 'the FRC should in future be funded largely by market participants'. The effect of this decision will be that the majority of the costs of the FRC will fall on business and the accounting and actuarial professions.

Whilst there is a statutory duty for the Professional Oversight Board to report to the Secretary of State on those activities that have been delegated to it, there is no such requirement on the FRC. Whilst we fully welcome the changes to the Board structure and the improved level of independent scrutiny, the FRC must recognise that it is carrying out a significant number of activities on the public's behalf.

Taking into account the public interest and the changes in the funding structure, we consider it important that the FRC is subject to an additional level of independent scrutiny and accountability. In coming to this conclusion, we note that the basis of the FRC's funding is similar to that of Government – it sets its own budget and imposes a direct charge on those subject to its functions.

One way that greater accountability could be achieved would be with an assessment carried out by the National Audit Office. This independent organisation seems well placed to fulfil this role. We suggest that the FRC considers inviting the NAO to carry out a financial assessment of the FRC on a periodic basis.

Another way in which the FRC could be providing greater visibility and transparency in its decision making process would be by making public responses to the consultation documents published by the FRC and its Operating Bodies available as soon as the Consultation has closed, for example published on the website within seven days of the closing date of the consultation

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<sup>4</sup> Link: [http://www.fsa.gov.uk/pubs/plan/pb2008\\_09.pdf](http://www.fsa.gov.uk/pubs/plan/pb2008_09.pdf)

process. This would allow market participants to assess the views of other interested parties and assist in ensuring that any FRC proposals are viewed as having the consensus support of respondents.

In considering the added financial burden the Government's funding decision will have on UK business, we do not believe that it is desirable or efficient for the FRC to be publishing a draft budget a few months before it takes effect. We would suggest that producing a two or three year rolling budget would allow the FRC to consider its longer term aims whilst assisting contributors to prepare properly their own budget.

We accept that the FRC may need to react to unplanned issues but consider that sufficient contingency could be built into the budget to provide for these eventualities.

Please let us know if you wish to discuss the contents of this letter.

We are content for this response to be published.

Yours faithfully

PricewaterhouseCoopers LLP

