



Financial Reporting Council

Feedback Statement

**FRC Consultation on its Draft
Strategy, Plan and Budget 2021/22**

Introduction

In February 2021, we published our Draft Strategy and Plan & Budget 2021/22, requesting comments by 12 March. The Draft Strategy set out our purpose and objectives, the key outputs and initiatives for 2021/22, our success measures, and our operational structure, governance and resourcing.

In the spirit of transparency, the FRC welcomes the feedback received from the twelve organisations that responded to our consultation (Annex A). The purpose of this Feedback Statement is to provide a summary and initial response to the main points that were raised.

A number of the respondents noted that there was a read-across to the Government's intention to consult on proposals for restoring trust in audit and corporate governance following the three independent reviews commissioned in 2018: Sir John Kingman's review of the FRC; Sir Donald Brydon's review of the quality and effectiveness of audit; and the Competition and Markets Authority (CMA) statutory audit services market study.

The Department for Business, Energy and Industrial Strategy (BEIS) published its consultation on the Government proposals on 18 March 2021, requesting comments by 8 July 2021. These proposals include the establishment of a new statutory regulator, the Audit, Reporting and Governance Authority (ARGA) to replace the FRC. In pursuing our core objectives and delivering our Plan & Budget in 2021/22 we will take careful account of the feedback we have received from our February 2021 consultation, as set out in this Statement. We will also take account of the Government's detailed intentions for the statutory objectives and governance of ARGA and its proposals to fund the new regulator through a statutory levy.

We will continue to engage with stakeholders during 2021/22 and will have regard to the comprehensive and constructive points that have been made in response to our consultation. A number of respondents have raised issues specific to themselves or their sector, which we will address with those respondents individually. We are also conscious that the BEIS consultation may prompt further input to our thinking on our priorities and work programme. We will welcome that further input, and look forward to an ongoing dialogue with stakeholders.

Our purpose and Objectives

Our 2021 Strategy sets out our purpose - *to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them* – and proposes five core objectives for our work in 2021/22:

Our objectives

To set high standards in corporate governance and stewardship, corporate reporting, auditing and actuarial work, and assess the effectiveness of the application of those standards, enforcing them proportionately where it is in the public interest.

To promote improvements and innovation in the areas for which we are responsible, exploring good practice with a wide range of stakeholders.

To influence international standards and share best practice through membership of a range of global and regional bodies and incorporate those standards into the UK regulatory framework.

To promote a more resilient audit market.

To transform the organisation into a new robust and independent regulator, acting in the public interest.

Comments received

Respondents expressed broad support for the FRC's progress towards ARGA and the proposed objectives and work programme for 2021/22 as set out in Section 2.2 and 2.3 of the Draft Strategy. One respondent specifically commended the FRC for our support for audit firms in developing alternative approaches to dealing with audit and regulatory issues that arose as a result of Covid-19. We recognize that this has been a collaborative effort with firms and regulators. Other positive comments include support for our proportionate and risk-based approach to enforcement, and for our stakeholder outreach. There was broad agreement with our approach to the supervision of the major audit firms and for our programme of work to raise standards of auditing, though several respondents called for greater clarity on we consider to be 'high quality audit', our expectations of audit firms, and how we see our regulatory activities contributing to improvements in audit quality.

Some respondents called for the FRC's Strategy to be further developed, during the transition to ARGA, to focus more explicitly on its role as part of the wider regulatory system, working alongside other regulators.

Some audit firm respondents requested greater clarity on how the FRC intends to work collaboratively with the major firms and on the FRC's plans in relation to the PIE audit firms, and for promoting audit market competition.

One of the professional bodies suggested the FRC should more clearly state its priorities for the non-audit aspects of the accountancy profession (specifically the role of management accounting, in support for better reporting and corporate governance).

Several respondents drew attention to the provisions of the Regulators' Code and asked whether it had been taken into account in developing the proposed Plan & Budget for 2021/22, including the impact of our work on smaller entities.

A number of respondents commented on our success measures and proposed key performance indicators (KPIs) as set out in Section 2.4 of the Draft Strategy. There were suggestions for enhancing the usefulness of the KPIs. In particular:

- Some respondents suggested that the FRC needed further to consider the correct KPIs for its supervisory and monitoring work and set additional qualitative KPIs that more clearly demonstrate how our work will directly improve audit quality.
- One respondent suggested that we should set an additional KPI to track innovation in the audit market as a KPI; the firm suggests adopting KPIs around the number of forward-looking recommendations made to audit firms, and then over time, judge their effectiveness by the proportion of successfully adopted recommendations.
- Respondents also suggested setting a smaller number of KPIs which are directly related to our purpose of setting high standards of governance, reporting and audit – including a KPI to measure the success of regulatory standards.

Response

The Government consultation now launched will set the broad policy framework for ARGA. The Government propose a broad general objective for ARGA which does not preclude the new regulator from setting its own strategic priorities. The FRC, and in future ARGA, will continue to consult stakeholders on our objectives and annual work programme.

We do not propose to amend the core objectives we have set for 2021/22, but we will take note of stakeholders' views on the links between different aspects of our work. We note the broad support for our 2021/22 work programme.

We confirm that in delivering the Strategy 2021/22 and in planning our work programme we will follow the core principles of proportionality, consultation, accountability, targeting and consistency. But we acknowledge respondents' concerns that we should do more to communicate how we comply with the provisions of the Regulators Code, including in relation to the smaller entities that are subject to aspects of FRC regulation. This is in line with the Government's intentions that the FRC and ARGA will comply with the Regulators' Code.

The FRC notes the points that have been made on the success measures set out in the Draft 2021/22 Strategy. These points are constructive and insightful and will help develop the mechanisms through which ARGA sets its broad objectives and tracks progress towards them. We published our Approach to Supervision on 25 March 2021 and are keen to develop measures of outcomes not just outputs. As we prepare for ARGA we will evolve the strategy for supervision, including for audit quality.

In reporting on progress during 2021/22, the FRC will:

- Bring together the qualitative indicators set out in the annual assessments (published separately) of progress in the quality of corporate governance and investor stewardship, corporate reporting and auditing.
- Develop further quantitative indicators, including in relation to innovation and the impact of regulatory standards.

We will continue to develop success measures geared to outcomes rather than simply to inputs and set out the rationale for the measures we have chosen, and – where it is appropriate for assessing progress – the targets we have set.

Our resources and funding

The consultation document set out our intention to seek additional resources. The final budget has decreased by £0.7m on the draft published as a result of a saving of £0.7m due to re-projected staffing costs and Board and Committee fees during the year. As such, the budget will increase by £6.1m (and not £6.8m as published in the Draft Strategy), of which half will increase our capacity and capability, and undertake new activities as recommended by the Kingman, Brydon and CMA reviews, and half will fund the establishment of the UK Endorsement Board (UKEB) following the UK exit from the EU.

Staff costs account for the largest element of our budget. Section 3.4 of the Draft Strategy sets out the proposed increases in the staffing of each of our core areas of activities: Regulatory Standards, Supervision, Enforcement and Corporate Services.

Comments received

Respondents support the FRC's transition to a larger authority with responsibilities and acknowledge the need for additional resources. However, a number of respondents:

- Sought further clarity on the rationale for the increases in the FRC's budget and for the budget set for the UKEB.
- Questioned the increase in the costs for Corporate Services.
- Questioned the increased proportion of the funding requirement sought from the audit and accountancy profession.
- Questioned the increase in the preparers levy and the resources allocated to the UKEB.

Two respondents questioned whether the budget was in line with the requirements of the HM Treasury guidance on Managing Public Money, which sets the framework for public bodies' expenditure and funding.

As a longer-term issue, several respondents asked the FRC to consider publishing three-year budgets in future to help market participants who will bear the costs of implementing FRC regulatory objectives to plan ahead.

Response

The FRC's budget reflects both its increased regulatory activities and the transition to a larger authority with enhanced powers and responsibilities. The FRC has considered carefully each aspect of the budget and the importance of maintaining the pace of our transition to ARGA.

In response to respondents' specific points:

- Although we will implement the budget as proposed we will ensure that our resources are focused on the delivery of our core regulatory responsibilities and the transition to ARGA, and will actively seek efficiency savings. Any such savings will be reflected in the amounts we recover from our funding groups.
- The budget for Corporate Services has two particular components: HR, IT and finance support for the enhancement and expansion of the FRC as a whole; and direct legal and analytical support for our expanding front-line regulatory activities and the transformation programme. Hence the increase in the 2021/22 budget. As we complete the transition to ARGA further investment will be required to be ready for the new regulator, but we will keep under close review the level of resource that the Corporate Services division will require.
- In setting and allocating the funding requirement for regulatory work, we have sought to align the amounts we charge with the proportion of our activities that are directed at or benefit each funding group – hence the proportion of our funding that is recovered from the audit profession and large listed companies. We will consult during 2021/22 on the funding arrangements for ARGA and, as part of that consultation, will seek the views of all stakeholders including

the audit professional bodies and audit firms. We plan to agree the applicable principles and then develop the operational "rules" for an annual, statutory levy.

- The UKEB is an independent body, set up by Government and its budget is a matter for BEIS, though from 2021/22 the FRC will, at Government request, raise the UKEB's funding - through our preparers levy - and will oversee its use of resources.

As more general points, we can confirm that the FRC's expenditure and funding arrangements are agreed with BEIS, subject to scrutiny by the National Audit Office and Government Internal Audit Agency; and they are in line with the requirements of Managing Public Money.

We are keen to publish a three year plan and indicative budget, recognising the challenges of the transition to our new "ARGA" status. We agree that this will bring both transparency and clarity to the forward plan and the associated funding requirements.

Financial Reporting Council
April 2021

Appendix

Respondents to the FRC Consultation on its Draft Strategy, Plan and Budget 2021/22

Association of Chartered Certified Accountants

Consultative Committee of the Accountancy Bodies

CIMA

Deloitte LLP

Engine B

Ernst & Young LLP

KPMG

Mazars LLP

PWC

Quoted Companies Alliance

ShareAction

UK Shareholders' Association & ShareSoc



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