

The Financial Reporting Council

A Hampton Implementation Review Report

February 2010

Financial Reporting Council

This review is one of a series of reviews of regulatory bodies focusing on the assessment of regulatory performance against the Hampton principles and Macrory characteristics of effective inspection and enforcement. It was carried out by a review team drawn from the Better Regulation Executive, the Environment Agency and the Care Quality Commission.

Further information about the reviews can be found at:

<http://www.berr.gov.uk/whatwedo/bre/inspection-enforcement/page44029.html>

EXECUTIVE SUMMARY AND CONCLUSIONS

Key findings from the review:

The review team found that the Financial Reporting Council (FRC) demonstrated a very high level of compliance with Hampton criteria across most areas of its activities. The review team also found that the FRC adopted a positive approach to better regulation and was open to ideas to continually improve the delivery of its regulatory responsibilities.

The balance between stability and economic growth was well struck, with a very high level of support from the main stakeholder groups.

The FRC was found to operate with strong input from practitioners, supplemented by excellent wider consultation. However, the review team would suggest the FRC needs to ensure that the volume of consultation takes into account the potential burden on stakeholders. The review team found the FRC was easily accessible to main stakeholders on an ongoing basis.

The flexible 'soft law' approach to raising standards of corporate governance in listed companies was found to be world-class.

<p>Issues for follow-up identified during the review:</p>	<p>Although the review team concluded that the FRC was broadly Hampton compliant, the team did note a number of areas which it would recommend the FRC revisit and keep under review.</p> <p>An important area of challenge, identified by the review team, was the way in which the FRC monitored and demonstrated delivery of performance and outcomes. Reassuring metrics which enable both transparency and accountability of the FRC's outcomes is essential. However, it was recognised that such metrics are problematic for the FRC, given the model of regulation it operates. Nevertheless, the review team believes that more work is required to avoid future criticism and potential Hampton non-compliance. The review team recommends that the FRC revisits the use of its annual stakeholder survey and considers opportunities to utilise this to monitor future performance.</p> <p>The FRC could build on its efforts to broaden its stakeholder base to ensure greater involvement of small businesses, the investor community and other stakeholders.</p> <p>The review team recommends that the FRC could formalise its approach to evaluating costs and benefits of its proposals both ex ante and ex post.</p> <p>The FRC should carefully review the scale of inspections on auditors to ensure they are proportionate and effective.</p> <p>The FRC may want to continue to monitor sustainability information when contained in annual reports and to consider updating its existing guidance on narrative reporting if and when appropriate.</p>
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INTRODUCTION

Introductory background information about the regulator:

The FRC was established in 1990, following the recommendation of the Dearing Report, to promote good financial reporting through its two subsidiaries - the Accounting Standards Board (ASB) and the Financial Reporting Review Panel (FRRP).

The FRC became the 'guardian' of the Combined Code of corporate governance in the late 1990s.

The FRC's role and remit was greatly expanded in 2004 to include setting auditing standards, oversight of the regulation of the auditing and accountancy professions and professional discipline in public interest cases.

Finally, the FRC took on the responsibility for setting actuarial standards and oversight of the regulation of the actuarial profession in 2006 and professional discipline in public interest cases.

The legislation establishing the regulator:

The Financial Reporting Council's functions and responsibilities derive from a number of sources. A number of statutory powers have been delegated directly to its relevant Operating Bodies. Some of its functions are supported by statutory obligations on other parties to meet its requirements and/or participate in arrangements provided by the FRC. Some of its functions have no statutory backing but derive their authority from widespread support from, and voluntary arrangements with, its stakeholders.

The regulator's statutory remit or objectives:

The FRC has an overall aim to promote confidence in corporate reporting and governance, in pursuit of the outcomes defined in the FRC's published regulatory strategy (April 2009):

Corporate governance - UK companies with a primary listing in the UK are led in a way which facilitates entrepreneurial success and the management of risk.

Corporate reporting - Corporate reports contain information which is relevant, reliable, understandable and comparable, and useful for decision-making, including stewardship decisions.

Auditing and related services - Users of audit reports can place a high degree of reliance on the audit opinion, including whether financial statements show a true and fair view, and users of audit-related services can place an appropriate degree of reliance on the reports provided.

	<p>Actuarial practice - Users of actuarial information can place a high degree of reliance on its relevance, transparency of assumptions, completeness and comprehensibility.</p> <p>Professionalism of accountants and actuaries - Clients and employers of professionally qualified accountants and actuaries and of accountancy and actuarial firms can rely on them to act with integrity and competence, having regard to the public interest.</p>
The regulator's budget:	The FRC budget for 2009/10 is £19.7 million. It receives £2 million grant-in-aid funding from BIS and external funding via an annual levy from preparers of accounts and from the financial reporting professional bodies.
Number of staff (including breakdown of policy and frontline staff):	<p>In addition to both paid and unpaid Board members, the FRC has a total of 95 employees:</p> <p>Professional: 72 (Full Time 54 and Part Time 18) Administration: 23 (Full Time 17 and Part Time 6)</p>
The sectors and number of businesses regulated either directly or indirectly:	<p>FRC standards and requirements impact on about 3.5million UK companies. The FRC focuses its regulatory activity, in particular, on entities in which there is a public interest, including approximately 3000 publicly traded companies and the largest private companies. This includes some of the larger bodies in the UK. Additionally, it regulates the recognised supervisory bodies which represent around 220,000 professional accountants and 4,500 actuaries.</p> <p>Its major stakeholders are recognised as: professional bodies (accountancy and actuarial), industry bodies such as CBI or the 100 Group - Finance Directors from FTSE 100 companies. Other stakeholders include the major audit firms.</p>

THE HAMPTON VISION

“Both the Hampton and Macrory reports are concerned with effective regulation - achieving regulatory outcomes in a way that minimises the burdens imposed on business. Key to this is the notion that regulators should be risk-based and proportionate in their decision-making, transparent and accountable for their actions and should recognise their role in encouraging economic progress.”

Any findings relevant to whether the review team believes the regulator is risk-based:

The FRC has embedded risk analysis within its systems well to guide and prioritise its work in a range of ways:

Strategically, its risk tolerance is broadly identified in its acceptance that failure will happen: its “non-zero failure regime”. However, this does not specify what scale of failure is acceptable, nor how this will be measured.

Its approach to setting priorities in the Annual Plan is underpinned by a simple assessment of: “the risk to achievement of the outcomes and other elements” in the Strategic Framework.

The risk assessment identifies the extent to which the outcome is currently achieved alongside the “downside” and “upside” of risk materialisation. This builds into the culture of the organisation a breadth of vision accepting a range of outcomes are possible, not all of which will be detrimental. The simplicity makes the method easy to adopt and understand. It is believed to be an element of good practice.

However, focusing on the outcomes in the strategic framework narrows the organisational view. Where the beneficiaries of the outcomes are stated, they are all fairly industry-focused (UK companies with a primary listing, users of actuarial information, clients and employers etc). As a result, the risk analysis is fairly industry focused and potentially quite insular.

If the risk assessment were to look at the impact on, or outcomes for, individuals and communities (the public), the FRC risk tolerance (acceptable and unacceptable failure) could be described in that way. The “downside” and “upside” views could then be annotated to identify how acceptable (or not) those impacts/outcomes may be.

In this way, a range of transparency and accountability benefits could be achieved: communication with the public would be facilitated; accountability for grant-in-aid funding would be strengthened; opportunities to identify unintended

	<p>consequences would be boosted; the likelihood and impact of ‘regulatory capture’ would be reduced; the recognition of the role of the FRC within society would be strengthened and the FRC would be in a leading position to encourage industry to consider sustainable development in their work.</p> <p>This may make it possible for the FRC core belief in “wealth creation” to broaden, accepting that ‘wealth’ is not just financial. The UK Government's Common Sustainability Principles may provide a useful framework for this broader consideration of impacts/outcomes. (http://www.defra.gov.uk/sustainable/government/what/principles.htm)</p> <p>Tactically, the FRC governance arrangements require the Operating Bodies to keep under review any emerging risks or other matters which could affect those aspects of confidence in corporate reporting and governance which fall within their remits. This builds reactive alertness to big market issues into operating systems and ensures engagement with market participants at this stage. The FRC shares some operating risks by working with partners where it can to achieve its objectives.</p> <p>Additionally, the annual plan identifies certain areas of risk as specific topics to target in the inspection process “having particular regard during our inspection work in 2009/10 to audit issues relating to going concern, fair value accounting estimates and disclosures and the impairment of assets including goodwill and other intangibles”.</p> <p>Operationally, its effort is expended where it sees most risk to achieving its outcomes e.g. its monitoring activities are heavier for the big accounting organisations and lighter for the smaller ones.</p> <p>In particular, the Audit Inspection Unit’s (AIU) risk model is noted as an exceptional tool for analysis which enables the targeting of inspections.</p>
<p>Any findings relevant to whether the regulator is transparent and accountable:</p>	<p>The majority of feedback from stakeholders is that the FRC takes huge steps to help them shape its regulatory activities. They commented that people at the FRC are usually easy to access. They also said that good feedback was provided on consultation responses and reasoned arguments were published on the FRC website. Staff were said to be flexible around the process and were happy to give early informal feedback.</p> <p>There was strong feedback that the website was easy to</p>

	<p>navigate for those familiar with the FRC systems but more difficult if you were less familiar with the industry/FRC. On this latter point, it was noted that the work of the FRC would be clearer to those stakeholders less familiar with its work if its structure were presented in plain English.</p> <p>The FRC has recently moved from just publishing an annual overview of the work of the AIU to publishing reports on individual firms which has been welcomed by stakeholders. Communication around sanctions and enforcement activity is felt to be appropriate, effective and well directed.</p> <p>The review team did note, however, that stakeholders were fairly industry-focused and engagement with the public was understood by FRC to be unachievable. Considerable efforts had been made to engage with small business and investors but the considerable challenges of this had not been overcome.</p> <p>Transparency and accountability with respect to outputs is a particular challenge for the FRC. The arm's length approach to delivery, which is positive in many ways, makes transparency and accountability difficult to measure, define and communicate. The review team recommend that the FRC revisits this important area.</p>
<p>Any findings relevant to whether the regulator encourages economic progress:</p>	<p>The regulatory activities of the FRC have strong links to the UK's economic progress and its regulatory activities are broadly aligned with this outcome. The FRC demonstrated a keen awareness of its role and remit with respect to facilitating sustainable economic progress through promoting confidence in corporate governance and reporting.</p> <p>The FRC has sought to ensure that its regulatory activities provide suitable support for business and industry, balancing the burden of regulation against its responsibilities to ensure appropriate standards of governance and reporting.</p> <p>There is strong awareness among staff of the potential economic impacts of its activities, particularly with respect to corporate governance/reporting and auditing/actuarial standards.</p> <p>The review team identified the development of 'The Combined Code on Corporate Governance' as a good example of encouraging economic progress. This code is non-mandatory but operates on a 'comply or explain' basis. A number of stakeholders highlighted the importance of this code in ensuring good corporate responsibility to shareholders and its knock-on benefit for economic progress.</p>

	<p>Development Opportunities The FRC expressed an aspiration to review further the opportunities to include wider values which may include the Government's Sustainable Development Principles. This is welcomed and supported by the review team.</p>
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DESIGN OF REGULATIONS

Hampton Principles

“All regulations should be written so that they are easily understood, easily implemented, and easily enforced, and all parties should be consulted when they are being drafted.”

“When new policies are being developed, explicit consideration should be given to how they can be enforced using existing systems and data to minimise the administrative burden imposed.”

Key findings on Design of Regulations:

The review team found that stakeholders were at the heart of the FRC’s design of its regulations. The principles-based approach taken with the Combined Code is a particularly strong example.

The FRC could develop this approach by continuing its efforts to broaden its stakeholder base and reviewing its approach to evaluating the costs and benefits of its proposals.

Background information such as the regulator’s role in developing regulations:

Responsibility for the Companies Act and associated secondary legislation lies with BIS.

The FRC’s role is to promote high standards of corporate governance, which it does through the Combined Code, although it does not monitor or enforce its implementation directly.

The FRC also sets standards for auditing and actuarial practice and for specific aspects of financial accounting. As the UK is seeking convergence of standards internationally, the FRC has a key role in influencing international bodies, such as the International Accounting Standards Board.

Review findings:

The extent to which the review team believes the regulator is acting in line with the Hampton principles:

The FRC believes the flexible ‘soft law’ approach remains the most appropriate way of raising standards of corporate governance in listed companies. The review team found that all stakeholders continue strongly to support the principles-based approach of the Code and the flexibility provided by “comply or explain”. The FRC’s approach is that responsibility for achievement of the standards rests with the decision-makers and stakeholders said they clearly understood it was not a “comply or else” approach.

Whilst all stakeholders wanted the approach to remain,

	<p>some pointed out that the FRC could provide more thought leadership on the application of the code in practice and on boardroom behaviour.</p> <p>The Boards in the FRC which set the standards across audit, actuarial, accounting and corporate governance are practitioner-led (with the exception of the Auditing Practices Board which limits the practitioners to 40%) and so stakeholders are at the heart of the design. However, it is clear that consultation goes much more widely and the typical approach is to have informal pre-consultation with the wider community, followed by two rounds of formal consultation before final standards are set.</p> <p>The recommendations here are that the FRC should be mindful of consultation overload and should prioritise the questions it consults on to limit the number of consultations taking place at any one time. The FRC could also improve the design of standards through greater involvement of small businesses, the investor community and other stakeholders. However, stakeholders recognised the challenges involved here.</p> <p>In addition, the FRC could review its approach to evaluating the costs and benefits of its proposals. It was clear that this was thought about and debated in the process, but more detailed analysis would add value.</p> <p>The FRC could also make better use of Post Implementation Reviews. Stakeholders saw these as a key mechanism for reviewing some of the complexity and length in the standards and comparing the actual implementation costs with the original forecasted costs.</p>
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ADVICE AND GUIDANCE	
<i>Hampton principle</i>	
<i>“Regulators should provide authoritative, accessible advice easily and cheaply”</i>	
Key findings on Advice and Guidance:	The review team found that all advice and guidance was jointly developed with stakeholders and was freely available on the FRC’s website.
Background information such as the means by which the regulator provides advice and guidance:	The FRC has maximised use of its website to promote its guidance and advice. It is easily searchable for stakeholders familiar with the FRC’s work and contains all key documents.
Review findings: The extent to which the review team believes the regulator is acting in line with the Hampton principle:	Stakeholders commented that they were involved in the development of the advice and that the focus was on making it as easy to understand as possible. Where changes take place, the FRC make every effort to pinpoint the changes and give guidance appropriate to firm size and sector. For example, when the audit standards were re-written, the FRC highlighted the text for UK changes and set out worked examples for application to smaller entities. The speed and effectiveness with which the FRC brought together stakeholders to develop jointly and communicate temporary guidance for going concern and liquidity risk in the period of the financial crisis has been highlighted as excellent practice.

DATA REQUESTS	
<i>Hampton principle</i>	
<i>“Businesses should not have to give unnecessary information or give the same piece of information twice.”</i>	
Key findings on Data Requests:	<p>The nature and style of regulation undertaken by the FRC requires only occasional data requests from stakeholders beyond public data to support key facts publications. Other data requests are limited to exceptions, risk-based audits and investigations associated with complaints.</p> <p>Stakeholders appear to value highly the low burden associated with this approach.</p>
Background information such as the data required by the regulator; the means by which business can return data etc:	<p>The mode of regulation operated by the FRC encourages and facilitates a high degree of self-monitoring and self-reporting against best practice criteria and guidance. The FRC oversees the regulatory activities of the professional accountancy and actuarial bodies. These bodies regulate their members. The FRC takes a risk-based auditing and inspection role and market entry system. Data requests for these activities are targeted and stakeholders felt they were relevant to these activities.</p>
Review findings: The extent to which the review team believes the regulator is acting in line with the Hampton principle:	<p>The review team considered the FRC’s approach to data requests to be in line with Hampton principles for the majority of its activities. As an exception, the team did note that the relationship with the actuarial profession was settling down. As monitoring the actuarial profession is a new area, the review team would suggest that the FRC reviews this area to ensure consistency with other boards.</p>

INSPECTIONS	
<p><i>Hampton principle</i></p> <p><i>“No inspection should take place without a reason.”</i></p>	
Key findings on Inspections:	<p>Stakeholders were generally supportive of FRC’s monitoring and inspection processes. Unanimously, they said they would rather have good regulation than none.</p> <p>Inspections were targeted and proportionate according to risk. However, the overall scale of individual inspections in some cases was questioned.</p> <p>The FRC works hard to ensure its findings are evidence-based, but this means the investigation process is tenacious and the threshold for reporting is quite high. As a result, sometimes messages can be delayed or buried. However, reports are welcomed as useful documents.</p>
Any relevant background information such as the number of inspections and the number of businesses inspected; the regulator’s risk model etc	<p>The FRC promotes high standards of corporate governance through the Combined Code, but does not monitor or enforce its implementation by individual boards; sets standards for auditing and actuarial practice and for specific aspects of financial accounting; and monitors and enforces accounting and auditing standards for listed and other major public interest entities.</p> <p>Accountancy regulation is far more developed than actuarial regulation. The nature of the regulated entity is also different: FRC regulates accountancy <u>firms</u>, but <u>individual</u> actuaries.</p> <p>It was felt that the objectives of inspections could be clearer: were they intended to prove fitness to practice or to improve quality of auditing or both? Clarity here would improve clarity over the form of inspection.</p> <p>FRC’s inspection processes are commended for beginning with an initial assessment of publicly available data on a company.</p> <p><u>Audit Inspection Unit (AIU)</u></p> <p>The Audit Inspection Unit, part of the Professional Oversight Board (POB), is responsible for monitoring the audits of all listed and other major public interest entities. As a result,</p>

the AIU focuses on the largest audit firms in the UK.

The AIU carries out full scope inspections involving reviews of both firm-wide procedures and a sample of individual audits. The statutory basis for the AIU inspection arrangements is set out in the Companies Act 2006.

The AIU inspection process operates through an electronic Audit Management System. All records are electronic and paper-based files are not maintained. The inspection process includes a filtering mechanism whereby satisfactory responses to items on an initial query list means that the matter is not taken forward to the second stage and therefore no formal written response is required from the firm. However, stakeholders were concerned that the process did not adequately prioritise the queries or focus on the important points.

The AIU has about 20 staff and maintains a significant presence in the largest auditing firms (PwC, KPMG etc) throughout the year. The inspection is a lengthy process which can take some 18 months to resolve. AIU staff review approx 5% of the eligible annual audit assignments for each firm. For example, for one firm, for the year end 07/08, 16 out of a total of 300 individual audits were inspected by the AIU before December 08. Between December 08 and February 09 the “firm-wide” systems audit was undertaken. The private annual inspection report was drafted February to June 09 and the public report drafted June to November 09.

The risk analysis supporting the targeting of AIU inspections is highly commended.

Stakeholders suggested that inspections could be streamlined if they were to focus on systems and processes, rather than “second guessing” individual decisions made on audit files. This is likely to be difficult to implement by FRC when individual audit decisions have huge impact. In addition, it would contradict the ‘outcomes focus’ of modern regulation.

The reports were seen as good and the contents were helpful: they “cover all the bases but are only partly regulatory”. The latter comment reflects one stakeholder’s feeling that the scope of inspections had expanded beyond the regulatory remit.

Professional Oversight Board (POB)

Primary responsibility for the audit inspection of the smaller

	<p>audit firms is mainly undertaken through the recognised supervisory bodies. More explicit partnership working with these bodies may help to reinforce this link and bridge a potential gap in regulation between public interest firms and individual professionals.</p> <p>The POB monitors the work of the recognised supervisory bodies with whom it works to uphold standards. Its annual inspection lasts two weeks. Reports from 07/08 activity had been received in November 09. In the meantime, the 08/09 inspections had been undertaken so the opportunity to improve had been hampered.</p> <p>One stakeholder recognised that strategic objectives sometimes took time to be reflected in inspection practice: strategically, market entry was being promoted by a suggestion that large companies may benefit from splitting their audit among different audit firms; operationally, a firm had been criticised for doing exactly that.</p> <p><u>Financial Reporting Review Panel (FRRP)</u></p> <p>FRRP inspections are also targeted primarily on the basis of risk assessment. Annual reports and accounts are selected from across the full range of companies within the Panel's remit and are also selected for review on the basis of company specific factors and complaints. Reviews focus on specific sectors which have been identified through a process which involves consultation with the FSA and an element of stakeholder engagement. During 2009/10 the FRRP inspected about 300 of the 3m potentially eligible bodies. The FRRP has access to those parts of the AIU risk analysis system which are publicly available, though we believe that the FRRP could consider further developing its risk analysis system on the AIU lines.</p>
<p>Review findings:</p> <p>The extent to which the review team believes the regulator is acting in line with the Hampton principle:</p>	<p>Inspections are clearly targeted and proportionate,; the AIU risk model is particularly impressive. Extensive use of publicly available information was also seen as good practice. However, the scale of the inspections of large audit firms has been questioned and the length of the reporting cycles generally seem to be very long (although recent improvements in reporting have been welcomed).</p>

SANCTIONS	
<p><i>Hampton & Macrory principles</i></p> <p><i>“The few businesses that persistently break regulations should be identified quickly, and face proportionate and meaningful sanctions.”</i></p> <p><i>“Regulators should be transparent in the way in which they apply and determine administrative penalties.”</i></p> <p><i>“Regulators should avoid perverse incentives that might influence the choice of sanctioning response.”</i></p> <p><i>“Regulators should follow up enforcement actions where appropriate.”</i></p>	
Key findings on Sanctions:	<p>The FRC’s functions and responsibilities derive from a number of sources. A number of statutory powers have been delegated directly to the relevant Operating Bodies. Some of its functions are supported by statutory obligations on other parties to meet its requirements and/or participate in arrangements provided by the FRC - with associated sanctions. Other functions have no statutory backing but derive their authority from widespread support from, and voluntary arrangements with, stakeholders.</p> <p>The interventions relate to compliance with accounting standards (FRRP), the recognition of professional bodies for the purpose of audit (POB), the monitoring of audit quality (POB/AIU) and professional discipline (Accountancy and Actuarial Discipline Board).</p> <p>The FRRP interventions ladder provides an excellent range of interventions which builds well to higher impact options. However, sanctions in other Boards provide high level responses: a “nuclear option”. The review team suggests that the FRC explore ways to broaden the range of FRC responses and publicly reinforce messages about how FRC responses work alongside those of the supervisory bodies.</p>
Background information such as a summary of sanctions available to the regulator and any data on sanctions imposed	<p><u>Financial Reporting Review Panel (FRRP)</u></p> <p>The FRRP reviews accounts for compliance with the law and accounting standards. The Panel focuses on the annual accounts of public and large private companies and keeps under review interim and final reports of certain other listed issuers. It enquires into cases where it appears that the rules have not been followed - in the words of the</p>

<p>by the regulator:</p>	<p>Companies Act ‘where it appears to the Panel that there is, or may be, a question whether accounts comply with the requirements of this Act’.</p> <p>Where there may be a case to answer, the FRRP Chair appoints a group to conduct the enquiry, normally made up of five members including the Chair and the Deputy Chair. Other members are chosen from the Panel to provide a balance of experience relevant to the enquiry while avoiding any potential conflicts of interest. Members of the Panel outside the group are not normally involved and the group’s exchanges with the company are confidential.</p> <p>The group puts its concerns to the directors in correspondence and at meetings. The Panel encourages directors to consult their auditors, to involve their audit committee and to take any other advice they feel they need. The process is informal but is intended to combine efficiency with fairness. As defective accounts could mislead the public, the procedures need to allow for speedy rectification. The group aims to reach agreement with the directors of the company by persuasion. If the group is satisfied by the company’s explanations, the case is closed and the fact that an enquiry was made remains confidential. Where the directors agree to take remedial action the Panel issues a press notice. The Panel does not comment on or discuss its conclusions further. The review team did not ask how issues included in reports were followed up to ensure that system changes were made to prevent recurrence.</p> <p>The Companies Act 2006 provides for the FRRP, where necessary, to apply for a court order requiring the revision of non-compliant accounts. This power has not been used.</p> <p><u>Professional Oversight Board (POB)</u></p> <p>The POB is responsible for independent oversight of the regulation of the auditing profession by the recognised supervisory and qualifying bodies. It discharges the statutory responsibilities delegated by the Secretary of State for authorising professional accountancy bodies to act as supervisory bodies and/or to offer a recognised professional qualification in relation to statutory audit.</p> <p>The POB has the “nuclear option” of de-recognising a professional body, but in practice discharges these responsibilities through inspection and dialogue</p> <p>The Audit Inspection Unit (AIU) of the POB monitors the quality of the auditing function in relation to listed</p>
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companies and any other entity in whose financial condition there is a major public interest. Its “sanctions” are to publicise shortcomings in the quality of auditing and, where necessary, individual audit firms.

The AIU issues individual public reports on the findings of its inspections of the Big 4 Firms and the other major firms inspected in that year. It also issues an overview report for each year which outlines key overall findings from its inspection work. In addition, it issues reports on individual audits reviewed by the AIU to the relevant audit firms with a view to them being made available by the firms to the directors of the audit clients concerned.

Stakeholders praised AIU report publications which had recently improved and were now more informative.

Accountancy and Actuarial Discipline Board (AADB)

The AADB is an independent body which investigates the conduct of members, or member firms, of the professional accountancy bodies and the actuarial professional bodies. It is responsible for taking disciplinary action in public interest cases - matters which raise, or appear to raise, important issues affecting the public interest. The arrangements for independent investigation and/or disciplinary hearings provided by the AADB amount to “appropriate independent arrangements” within the terms of the Companies Act 2006. In order to achieve recognised supervisory body status a supervisory body must participate in these arrangements.

The bye laws of the actuarial and accountancy professional bodies provide that their members are subject to the AADB actuarial scheme. These provisions are supported by the Memorandum of Understanding between the FRC and the professions.

All other disciplinary matters are dealt with via the disciplinary structures of the recognised supervisory bodies or other participants in the AADB schemes.

Individuals and firms subject to the disciplinary arrangements are required to cooperate with AADB investigations and proceedings, e.g. by providing documents and other information, attending interviews and giving evidence to the Disciplinary Tribunal. Tribunals are held in public.

If a Tribunal upholds a complaint, it can impose a wide

	<p>range of sanctions, including:</p> <ul style="list-style-type: none"> • Reprimand or severe reprimand • Unlimited Fine • Waiver or repayment of client fees • Withdrawal of practising certificate, registration, authorisation or licence • Expulsion or exclusion from Membership for a recommended period, up to 5 years.
<p>Review findings:</p> <p>The extent to which the review team believes the regulator is acting in line with the Hampton principles and Macrory characteristics:</p>	<p>Stakeholders reported being kept well informed about AADB cases and prospective investigations but were not aware of the detail of allegations or what happened if cases were dropped.</p> <p>Given the non-zero failure regime, the level of application of sanctions is interesting. This may be because limited options are available to FRC, because they only have the options as set out in the Scheme.</p> <p>It is recommended that the FRC review the possibility of using or publicising a broader range of sanctions across their remit and in partnership with recognised supervisory bodies (RSBs). This may involve investigation of gaining Macrory powers.</p>

FOCUS ON OUTCOMES

Hampton principle

“Regulators should measure outcomes and not just outputs.”

Key findings on Focus on Outcomes:

The primary role of the FRC, promoting confidence in corporate reporting and governance, is intuitively aligned with the needs of the business sector.

The FRC published its ‘Regulatory Strategy: Our Role and Approach’ in April 2009. This document clearly sets out the regulator’s aims and its six key strategic outcomes, which cover:

1. Corporate governance
2. Corporate reporting
3. Auditing and related services
4. Actuarial practice
5. Professionalism of accounts and actuaries
6. FRC effectiveness

Based on interviews with stakeholders it was apparent that the FRC had consulted widely on these objectives and secured the broad support of its stakeholders through good communications.

The real challenge for the FRC in this respect is its ability to measure outcomes and to do this with transparency and accountability. Although both the FRC and its stakeholders feel positive, it is difficult for the FRC to develop reassuring metrics for outcomes beyond the negative proving the positive. The annual use of a stakeholder survey is one useful metric but is very much based on perceptions rather than actual measurable performance. It was also noted that this process is currently only focused on specific stakeholder groups.

Development Opportunities

It is recommended that the FRC revisits the use of the annual stakeholder survey to ensure:

- it enables a representative cross section of stakeholders
- provides a longer term picture of trends in confidence
- provides a basis for outcomes metrics

<p>Background information such as the regulator's key objectives:</p>	<p>The primary objective of the FRC is to promote confidence in corporate reporting and governance for the benefit of economic progress. This overarching objective is underpinned by the six key strategic outcomes highlighted above.</p> <p>The FRC Annual Report 2008/09 provides a comprehensive statement of its objectives, outputs and perceived performance. The Annual Report is further supported by a good range of published documentation under each of its six key strategic outcomes.</p>
<p>Examples of good practice:</p>	<p>The FRC largely provides oversight, direction and non-mandatory guidance/codes. The use of Operating Bodies and delegation to professional bodies is a positive model which appears to work well, liberating responsibility and reducing regulatory burden. This model, with its high degree of self regulation/self monitoring, requires the FRC to maintain ongoing engagement with the business community.</p> <p>The use of Operating Bodies, Professional Bodies and the wide, but appropriate, use of consultation is an example of good regulatory practice. The interview process with stakeholders did, however, highlight some tensions and frustrations. The accountability of the FRC is less clear than many comparable regulators which have clear, measurable, outcomes for respective regulated sectors. The apparent lack of accountability for outcomes and the perceived delegation of accountability without authority/responsibility was highlighted by some stakeholders.</p> <p>The documentation produced by the FRC with respect to outcomes is comprehensive and well written. The only concern with these outcomes is the lack of metrics which would provide a more objective assessment of delivery than the current model. It is clear that developing such metrics would be challenging and in itself may increase regulatory burden through the need for additional data collection.</p>

<p>The extent to which the review team believes the regulator is acting in line with the Hampton principle:</p>	<p>Stakeholders confirmed that they were aware of the FRC's aims and objectives and demonstrated positive support for these. The FRC demonstrated good alignment with Hampton principles with respect to the delivery of its outcomes.</p> <p>The Hampton principles were not explicitly highlighted in either the documentation or the interviews held with staff. It appeared that the principles were implicit within the mode of regulation adopted by the FRC. It was not always entirely clear if the implicit nature of the Hampton principles within the mode of regulation was by design or more a fortunate by-product of the FRC setup.</p>
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Appendix 1: review team membership

Chad Woodward is an Assistant Director in the Better Regulation Executive in the Department for Business, Innovation and Skills. His background is in policy, project management, sales and marketing within the public and private sectors.

Trevor Bishop is Head of Water Resources Policy for the Environment Agency. Trevor's background is in water industry management with a specific emphasis on national water policy since joining the Environment Agency in 2005.

Tania Clarke has a background in management of 'messy' change in the civil service, regulation, farming, forestry and health. At the Care Quality Commission she leads on the development of methods and processes to analyse regulatory risk and enable collaborative working. Tania joined the Commission in November 2004 to enable implementation of the 'Concordat between bodies inspecting, regulating and auditing healthcare'. This was an agreement between 21 partner organisations to deliver joint implementation of the Hampton principles.

Better Regulation Executive
Department for Business, Innovation and Skills
3rd Floor
1 Victoria Street
London SW1H 0ET

Website: www.bis.gov.uk/bre

URN: 10/690

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