



# **FINANCIAL REPORTING COUNCIL**

## **LEVY PROPOSALS 2008/09**

**FEBRUARY 2008**



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## **One - Introduction**

The FRC is the United Kingdom's independent regulator for corporate reporting and governance. Our aim is to promote confidence in corporate reporting and governance, which we see as vital to the healthy functioning of business and markets and under-pinning wealth creation.

This document explains our proposals for our funding arrangements for 2008/09, specifically:

- funding our responsibilities for accounting, auditing and corporate governance and our 2008/09 business levy
- funding our responsibilities for actuarial standards and regulation and our 2008/09 insurance and pension levies.

Responses to the levy proposals are invited by 30 April 2008. We aim to publish our final rates in June 2008.

This document is designed to be read in conjunction with our Draft Plan & Budget 2008/09, <http://www.frc.org.uk/about/>, which we published in January 2008. It sets out details of our proposed priorities for 2008/09, and the costs we expect to incur, inviting comments by 14 March 2008.

### **Changes in Government contribution**

For some years, the Government has contributed a third of our core operating costs in relation to our responsibilities for accounting, auditing and corporate governance. On 6 February, the Government announced that our responsibilities for accounting, auditing and corporate governance should in future be funded largely by market participants.

The Government has confirmed that it will continue to make a substantial contribution to our costs for at least the 2008/09 financial year. We have, therefore, prepared our levy proposals for 2008/09 on that basis.

The Government has asked us to consult market participants on the options for new funding arrangements. In April we will publish a consultation document on our future funding arrangements seeking comments from our stakeholders. No changes to the arrangements for the funding of the FRC's responsibilities for actuarial standards and regulation are presently envisaged.

We will continue to operate our funding arrangements on the basis of our commitment to the principles of good regulation and ensure that they are transparent, proportionate, and cost-effective, and are subject to timely consultation.

## **FRC's role and responsibilities**

Our Regulatory Strategy, which was updated in November 2007, is available on our website at <http://www.frc.org.uk/about>. It explains our role, responsibilities, governance and accountability, and our regulatory approach, which is based on the principles of good regulation. It also contains our Strategic Framework, established after consultation with our stakeholders, which defines the outcomes we believe contribute to confidence in corporate reporting and governance in the UK.

The functions we exercise can be summarised as follows:

- promoting high standards of corporate governance
- setting, monitoring and enforcing accounting and auditing standards
- setting actuarial standards
- statutory oversight and regulation of auditors
- operating an independent investigation and discipline scheme for public interest cases
- overseeing the regulatory activities of the professional accountancy and actuarial bodies.

Our functions are exercised principally by our operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy and Actuarial Discipline Board) and by the Committee on Corporate Governance.

The primary basis for our responsibilities relating to accounting and auditing is the UK Companies Acts and is relevant to companies incorporated in the UK. We also have certain responsibilities for non-UK companies which are derived from European Directives. Our responsibilities for corporate governance relate to UK companies with a primary listing in the UK.

From April 2006, at the request of HM Treasury, we assumed responsibility for actuarial standards and regulation.

We are a non-profit making organisation. Our intention in raising funds in relation to all our activities is merely to recover our costs and to ensure that we have an appropriate level of reserves.

Our Financial Management and Reporting Framework (set out in our Regulatory Strategy) provides the framework within which we manage and report on the costs of our activities and how they are funded. While we endeavour to secure value for money in all our expenditure, we believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs.

## Two - Funding our responsibilities for accounting, auditing and corporate governance

Under current arrangements, our core operating costs in relation to accounting, auditing and corporate governance are funded by the accountancy profession, the business community and the Government. Certain other costs (e.g. of audit inspection, and case costs relating to the investigation and discipline of accountants) are funded entirely by the accountancy profession.

The business community's share of our core operating costs in relation to accounting, auditing and corporate governance is met by means of a business levy.

It is our intention to continue to raise our business levy on a non-statutory basis based on the widespread support in the business, investor and professional communities for our work. The non-statutory arrangements have worked successfully and flexibly since 1990. There is provision in the Companies Acts for the Department for Business, Enterprise and Regulatory Reform (BERR) to make our levy a statutory charge.

### Business levy 2008/09

#### Summary of the amount to be raised through the business levy for 2008/09

The total amount we are seeking to collect for the business levy in 2008/09 is as follows:

	<b>£m</b>
The business community's share of our core operating costs for 2008/09	4.2
less higher than expected levy collections in 2007/08	(0.2)
plus a contribution to our reserves	0.1
<b>FRC funding requirement</b>	<u>4.1</u>
plus the UK contribution to the funding of the IASB	<u>0.7</u>
<b>Total business levy</b>	<u><u>4.8</u></u>

The explanation for each of these items is as follows.

#### *The business community's share of our core operating costs*

Our proposed Budget for 2008/09 will result in core operating costs in relation to corporate governance, reporting and accounting of £11.9m compared to £10.9m in 2007/08.

The precise amount of the Government contribution for 2008/09 has not yet been determined. For planning purposes, the FRC has assumed a Government contribution at a similar level to 2007/08, approximately £3.5m. We propose that the other two funding groups, the accountancy profession and the business community, will each contribute half of the remaining costs. On this assumption, the contribution from the business community towards core operating costs will, therefore, be £4.2m.

### *Over-collection from the 2007/08 levy*

We have forecast that the amount collected from the business levy in 2007/08 will exceed the amount we require by £0.2m. We propose to offset this amount against the business levy required for 2008/09.

### *Contribution to our reserves*

The FRC's Directors believe that it is prudent for us to maintain general reserves in relation to our responsibilities for accounting, auditing and corporate governance to meet unforeseen expenditure and in recognition of the fact that we have entered into a number of long-term financial commitments. The level of reserves in recent years has been around £1m. As part of our arrangements to maintain this level of reserves we propose to collect an additional contribution of £0.1m from the business levy in 2008/09.

### *FRC funding requirement*

Based on the business community's share of our core operating costs, and taking account of the over-collection in 2007/08 and the contribution to our reserves, the overall FRC funding requirement in relation to the business levy for 2008/09 will be £4.1m. This compares to £3.5m in 2007/08, reflecting the increase in our core operating costs and the Government decision noted in the introduction to this document.

### *UK contribution to the funding of the IASB*

We will continue to take the lead on behalf of the UK business community in raising the UK contribution to the cost of the International Accounting standards Board (IASB) by means of the business levy. The work of the IASB falls directly within the scope of the FRC's national responsibilities. We expect the UK contribution to the IASB for 2008/09 to be £0.7m, the same level as for 2007/08.

The UK contribution to the IASB is not included within the FRC's funding arrangements. Information about IASB funding is available on the IASB website.

### **Our proposals for the business levy 2008/09**

We propose to raise the amount required for the business levy 2008/09 as follows.

### *Scope of the business levy*

The following companies will be subject to the business levy in 2008/09:

- companies with a listing on the LSE's Main Market (other than companies for which the home competent authority is another EEA country)
- UK companies quoted on the LSE's AIM market
- UK companies quoted on PLUS Markets.

We announced the decision to include UK AIM and PLUS Markets companies within the scope of the business levy for 2008/09 and future years, following public consultation, in May 2007. An explanation of the background to this decision is at Annex A to this document.

### *Key features of the levy*

The key features of the business levy remain unchanged from 2007/08:

- a minimum levy
- further amounts payable by companies above a certain market capitalisation, with the rate per £m of market capitalisation declining in five levy size bands.

The minimum levy and the rates for larger companies are calculated based on the number of listed or quoted companies and their market capitalisations as at 30 November in the year preceding the year to which the levy relates (ie the levy for 2008/09 will be based on data as at 30 November 2007). This date is the one on which the LSE and the FSA base their fees; adopting this date avoids the need for additional data collection and inconsistency with their fee calculations.

The amounts payable by companies of any given size will be determined by the decisions on:

- the amount of the minimum levy
- the size limit for companies to which only the minimum levy applies
- the speed at which the rates payable by larger companies decline.

Our proposed market capitalisation bands are identical to those implemented by the FSA for its UKLA fees and are unchanged from 2007/08, which will reduce the costs of collecting our levy. The proposed minimum levy and the rates in the other bands differ from those proposed by the FSA: the number of companies liable to pay our levy differs from those who pay the UKLA fees and our costs are also different.

Overseas companies listed and admitted to trading on the London Stock Exchange's Main Market and UK AIM and PLUS Markets companies receive a 50% discount on the rates to reflect the fact that not all our regulatory activities apply to them.

***Proposed levy rates for 2008/09***

On the basis of the data available to us at this stage, we believe we would be able to raise the amount we require with an increase of 10% in the minimum levy and 10% in the rates we apply.

If UK AIM and PLUS Markets companies were not included within the scope of the business levy we would have needed to increase the minimum levy and the rates we apply to LSE Main Market companies by 16%.

To allow companies to estimate the likely amount of the levy we have calculated provisional rates as follows based on the proposals in this paper:

<b>Band</b>	<b>Market capitalisation (£m)</b>	<b>Proposed levy per £m of market capitalisation 2008/09 (£)</b>	<b>Levy per £m of market capitalisation 2007/08 (£)</b>
<b>1</b>	Up to 100	Min levy £920	Min levy £840
<b>2</b>	100-250	6.05	5.50
<b>3</b>	250-1,000	4.62	4.20
<b>4</b>	1,000-5,000	3.30	3.00
<b>5</b>	5,000-25,000	0.055	0.05
<b>6</b>	>25,000	0.011	0.01

The following example illustrates the way in which the 2008/09 levy would be calculated for a UK LSE Main Market company with a value of £350m:

<b>Market capitalisation band (£m)</b>	<b>Levy payable at proposed 2008/09 rates (£)</b>	<b>Levy payable at 2007/2008 rates (£)</b>
<b>Up to 100</b>	920	840
<b>100-250</b>	908	825
<b>250-1,000</b>	462	420
	<b>2,290</b>	<b>2,083</b>

### *Collection arrangements*

The business levy is collected from companies listed and admitted to trading on the LSE's Main Market on our behalf by the Financial Services Authority (FSA) at the same time as the FSA invoices listed companies for their Listing Fees. This arrangement means that the incremental cost of collecting our levy from these companies is very low. We, not the FSA, are accountable for the amount of the levy and the amount of our levy is shown separately on the invoices.

We will collect the business levy from UK AIM and PLUS Markets companies using a collection agent.

### **Consultation questions:**

#### **1 Do you agree with our proposed levy rates for 2008/09?**

We will announce the final business levy rates in June 2008 when the final data on the number and size of companies subject to the levy is available.

### Three – Funding our responsibilities for actuarial standards and regulation

Our arrangements for funding our actuarial responsibilities are designed to ensure that pension funds, insurance companies and the Actuarial Profession contribute a reasonable share of the costs we incur, and that the arrangements for collecting the contributions are as straightforward and cost-effective as possible.

We fund our actuarial responsibilities on the following basis:

- A contribution from the actuarial profession equivalent to 10% of the total costs.
- A contribution from the insurance sector through a levy on the “insurance levy group” equivalent to 45% of the total costs. The insurance levy group comprises life and general insurance companies which are required to pay the relevant FSA regulatory fees (FSA fee blocks A3 and A4).
- A contribution from the pension sector through a levy on the “pension levy group” equivalent to 45% of the total costs. The pension levy group comprises pension schemes subject to the Pensions Regulator’s general levy.

In our response to the consultation on our funding proposals for 2007/08 we noted that some respondents had expressed concern that some work-based personal pension schemes might be subject to both the FSA and Pensions Regulator’s regulatory fees and hence contribute to both the FRC insurance and pension levies. We have carefully considered this issue but would propose to continue to operate our funding on a basis that is aligned with the arrangements operated by the Pensions Regulator and FSA. We consider that, in the absence of a clearly fairer alternative, the present basis remains the most straightforward and cost-effective basis for funding our actuarial responsibilities; but we will keep the issue under review.

We intend that our actuarial responsibilities should continue to be funded through non-statutory arrangements based on an understanding with the pension and insurance sectors and the Actuarial Profession. There is provision in the Companies Acts to make our insurance and pension levies a statutory charge.

#### Total funding requirement

The total amount we are seeking to collect in relation to our actuarial responsibilities in 2008/09 is as follows:

	£m
Actuarial operating costs	2.2
Actuarial disciplinary case costs fund	0.2
<b>Total</b>	<b><u>2.4</u></b>

We will seek a contribution of £240,000 (10% of total costs) from the Actuarial Profession with remaining requirement being met by the insurance levy (45% of total costs) and pension levy (45% of total costs).

### **Insurance levy 2008/09**

We will collect a levy of £1.1m from the insurance levy group. This will be allocated to individual insurance companies in the same proportion as the FSA regulatory fees and charged to insurance companies on the same invoice as the FSA fees. Our levy on insurance companies will be an amount equivalent to 1.7% of the FSA's estimated regulatory fees for Fee-blocks A3 and A4 for 2008/09 (£63m), announced in February 2008.

The levy will be collected on our behalf by the FSA at the same time that it collects its own fees. We will not be in a position to finalise the insurance levy rate until the FSA confirm their fees rates for the relevant Fee-blocks.

### **Pension levy 2008/09**

We will collect a levy of £1.1m from the pension levy group. This will be allocated to individual pension schemes on the basis of the latest scheme returns to the Pensions Regulator.

In order to secure this amount we expect to have to increase the levy to £3.00 per 100 members for 2008/09 compared to £2.20 per 100 members in 2007/08. We introduced the pension levy in 2006/07 and now have two years experience of operating the levy. We are aware that the population of schemes subject to the Pensions Regulator's general levy is smaller than we had assumed when we set the rates for 2006/07 and 2007/08. This is the principal reason for the increase in the levy rate we are proposing for 2008/09.

For 2008/09, there will be a de minimis contribution of £30. This will have the effect of including within the scope of the levy only those schemes with 1,000 or more members - around 2000 schemes, representing approximately 85% of the total membership of pension schemes.

We will not be in a position to finalise the pension levy rate until the Pensions Regulator has confirmed the necessary data on scheme membership. We expect to invoice the pension levy group in July.

### **Consultation question**

#### **3. Do you agree with our proposed insurance and pension levy rates for 2008/09?**

We will announce the final rates payable in June 2008.

## **Annex A – Application of the business levy to UK AIM and PLUS Markets companies**

UK companies quoted on AIM and PLUS Markets and their auditors are subject to the accounting and auditing standards which the FRC sets, monitors and enforces. The only significant aspects of our work which do not apply to these companies are our work on the Combined Code on Corporate Governance and the implementation of the requirements of the 8<sup>th</sup> European Company Law (Auditing) Directive relating to the registration and inspection of overseas auditors.

In 2005, we sought views on the proposal that UK AIM and PLUS Markets Group (then Ofex) companies should also be asked to contribute to the business levy in order to achieve a fairer distribution of costs across the business community. At that time we did not receive sufficient support from stakeholders to enable us to take this proposal forward, and we did not repeat it in 2006. In 2007 we consulted again. The response to that consultation was largely positive.

In June 2007, therefore, we announced that the business levy would apply to UK AIM and PLUS Markets quoted companies for 2008/09 and future years, with a discount of 50% on the minimum levy and market capitalisation-based rates we apply to London Stock Exchange Main Market companies. We explained that we would give further consideration as to how the business levy should be collected in a cost-effective way from these companies before we consult on our levy proposals for 2008/09.

The extension of the business levy to UK AIM and PLUS Markets companies is not intended to generate additional income for the FRC. It will, however, ensure a fairer distribution of the costs of our work across the business community. The inclusion of UK AIM and PLUS Markets companies within the levy means that we are able to set rates for companies listed on the Main Market which are lower than would otherwise be the case.

The market capitalisation bands mean that it is likely that the majority of UK AIM and PLUS Markets companies will pay only the minimum levy.

It is our intention to collect the levy from UK AIM and PLUS Markets companies using a collection agent.

## Contact Details

Comments on the Levy Proposals 2008/09 should be sent to:

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