Financial review

Basis of preparation

This financial review is based on the FSA's Financial Management and Reporting Framework, details of which are provided at the end of this chapter. Under this framework, net expenditure on core operating activities is identified as Ongoing Regulatory Activities (ORA) expenditure.

Table 8.1: Reconciliation of statutory accounts to the financial review

	£m
Net expenditure for the year per the statutory accounts	**547.1**
Add: Taxation	(1.8)
Net expenditure for the year including taxation per the statutory accounts	**545.3**
Add: difference between accounting charges for pension provisions in the statutory accounts and the related cash costs of pension contributions paid	36.1
Add: advanced funding received in respect of UKLA	(18.4)
Less: scope change (treated outside ORA)	(6.1)
Less: cost of regulatory Reform implementation (treated outside ORA)	(28.7)
Net ORA expenditure for the year	**528.2**

Net ORA expenditure

Net ORA expenditure for the year to 31 March 2013 was £528.2m, resulting in an £8.2m surplus against the £536.4m budget. It is reported net of an £18.4m drawdown of UKLA advanced funding, used to fund certain activities within the UKLA and Markets divisions and included within the £40.6m sundry income receipts in Table 8.2.

The FSA also spent £28.7m on regulatory reform implementation and £6.1m on activities that represented additional scope. This included work on the transfer of consumer credit, Alternative Investment Fund Managers Directive (AIFMD) and the Retail Distribution Review (RDR). The FCA will recover these costs in future years from entities specifically aligned to these initiatives once they have been implemented.

The tables below analyse the actual and budgeted 2012/13 costs in more detail. The budget reflects the reallocation of funds between cost lines throughout the year to ensure resources were made available for priorities as they emerged.

Table 8.2 Net expenditure by type

	2012/13 Actual £m	2012/13 Budget £m	2012/13 Variance £m
Staff costs (including travel, training, recruitment and pension scheme deficit reduction contributions)	380.7	365.3	(15.4)
Accommodation, office services and depreciation	76.7	80.2	3.5
IT costs (including IT delivery outsourcing)	62.9	64.6	1.7
Professional fees	19.9	18.5	(1.4)
Enforcement External Case Costs	10.2	12.6	2.4
Impairment costs	11.4	0.0	(11.4)
Printing, publications and other	7.0	6.2	(0.8)
CEO Contingency	0.0	14.8	14.8
Total expenditure	**568.8**	**562.2**	**(6.6)**
Sundry Income	**(40.6)**	**(25.8)**	**14.8**
Total net ORA expenditure	**528.2**	**536.4**	**8.2**

Staff costs were £15.4m higher than budget reflecting the FSA's decision to make a one-off £22.0m contribution to reduce the defined benefit pension scheme deficit that will be inherited by the FCA and mitigate the risks of significantly increased future annual pension deficit-funding contributions. This was partially offset by a £6.6m under spend, driven mainly by longer recruitment glide paths compared to the FSA's budget assumptions, together with underspends on travel and recruitment.

The £11.4m impairment cost over spend reflects the total costs of impairing assets, including £7.3m UKLA project impairments (funded by a release of advanced funding) and £2.0m write-downs of furniture and fittings prior to the release of two floors in Canada Tower at legal cutover.

The £14.8m CEO contingency fund was budgeted to mitigate financial and economic risks which did not arise.

Sundry income was £14.8m higher than budget, driven by the £7.3m release of advanced funding to fund UKLA project impairments and the receipt of unbudgeted special project fees.

Panel Costs and the Office of the Complaints Commissioner (included in ORA)

Total ORA includes £1.0m in respect of the cost of the Consumer Panel (£0.6m: £0.4m staff costs, £0.2m other) and the combined cost of the Practitioner and Smaller Businesses Practitioner Panels (£0.4m: £0.1m staff costs, £0.3m other). These figures include the costs of: people who support the Panels' work; independent research; Panel members' fees and expenses; and costs associated with the preparation of the Panels' annual reports. The overall costs of these panels were in line with budget.

In 2012/13 the FSA provided funding for the Office of the Complaints Commissioner (OCC) in relation to the costs of the Commissioner and his staff, accommodation and ancillary services. The OCC's total costs for 2012/13 were £0.6m, in line with budget.

Funding

The FSA was funded by fees payable by the organisations it authorised, recognised, registered or listed. During 2012/13 £568.0m in fees was raised directly from those fee payers (2011/12 505.9m).

These comprised: £536.4m ORA funding (2011/12 492.0m), £31.6m for Regulatory Reform; £2.4m to fund scope change and £8.2m additional fees (resulting from population and tariff data changes), offset by a £10.6m release of ORA reserves.

Financial penalties

As in previous years the FSA neither budgeted for financial penalties arising from disciplinary cases nor used them to fund its activities. During 2012/13 it collected penalties of £381.9m (2011/12 £70.7m). In prior years financial penalty receipts were used to reduce the fees levied by the FSA across relevant fee blocks. Following changes made by the Financial Services Act 2012, all financial penalty receipts in 2012/13 net of £38.2m enforcement costs were paid to the Exchequer in April 2013.

Table 8.3: Funding the FSA's net expenditure

	2012/13 £m	2011/12 £m
Total net costs for the year per the financial review	528.2	474.7
Under spend against budget (see reserves movement – table x)	8.2	17.3
ORA Budget	536.4	492.0
Additional funds raised		
Regulatory Reform	31.6	10.9
Outcomes-focused regulation transition	0.0	5.0
Scope change funding	2.4	1.6
Additional fee income	8.2	5.4
Movement of reserves to fund AFR reduction	(10.6)	(9.0)
	31.6	**13.9**
Fees income per statutory accounts	**568.0**	**505.9**

Balance Sheet

Financial Strength

The FSA had net liabilities of £87.3m at 31 March 2013 (31 March 2012: £66.1m), primarily as a result of pension liabilities of £114.7m, calculated under International Accounting Standard 19: Employee Benefits (IAS 19). Excluding the pension deficit, the FSA had a net surplus of £27.4m.

The pension liabilities will not crystallise for many years and the approach to managing and funding the pension deficit is explained in note 14 to the financial statements.

As at 31 March 2013 the FSA had £392.0m of cash and cash equivalents (31 March 2012: £72.0m) and our average cash balance was £291.2m in 2012/13 (2011/12: £163.9m). Up to 31 March 2012 the FSA made use of financial penalty receipts as working capital however under the Financial Services Act 2012, the FCA must pay financial penalties over and above the cost of Enforcement (£38.2m in 2012/13) to the Exchequer.

Nevertheless the FSA has strong fee covenants and a predictable cash flow/ working capital profile. The invoicing of firms is undertaken in three main tranches during the year to ensure the FSA has appropriate working capital and liquid reserves available to it to settle its liabilities as they fall due and meet its agreed liquid funds criteria. The minimum amount of immediate liquid funds for the FSA/ FCA has been set at a period of 6 weeks' ORA expenditure (£51.4m for 2013/14).

Movement in the FSA's reserves

The FSA Financial Management and Reporting Framework outlines the plan to keep ORA reserves at +/-2% of ORA budget. This takes into account the broader financial risk management and the ability to draw on the revolving credit facilities.

The movements in the FSA's reserves can be summarised as follows:

Table 8.4: Reserves/ (Deficits) movements

	ORA reserves £m	Scope change £m	Advanced Funding £m	Regulatory Reform £m	Pension Reserve £m	Total £m
At 1 April 2012	24.0	(5.0)	22.5	(0.5)	(107.1)	**(66.1)**
Annual Funding Requirement	(10.6)	2.4		31.6		**23.4**
Additional Fee income	8.2					**8.2**
Net surplus	8.2					**8.2**
Regulatory Reform Cost				(28.7)		**(28.7)**
Pension Reserve					(7.8)	**(7.8)**
Movement in Advanced Funding			(18.4)			**(18.4)**
Costs relating to scope change		(6.1)				**(6.1)**
Total movement for the year	**5.8**	**(3.7)**	**(18.4)**	**2.9**	**(7.8)**	**(21.2)**
Total statutory reserves at 31 March 2013	**29.8**	**(8.7)**	**4.1**	**2.4**	**(114.9)**	**(87.3)**

ORA reserves

The FSA's ORA reserves at 31 March 2013 were £29.8m (2011/12: £24.0m). £17.1m (2011/12: £10.6m) of this reserve will be used to reduce the fees needed in 2013/14. When combined with the Regulatory Reform surplus, this will reduce the 2013/14 AFR by a total of £19.5m. The remaining £12.7m is being carried forward as an ORA reserve.

Scope change

£6.1m costs related to scope change have been separately identified. The £8.7m accumulated expenditure will be recovered by the FCA in future years from appropriate fee blocks,

Advanced Funding

The advanced funding reserve separately identifies funds collected for specific projects/ activities principally related to UKLA and other markets-related activities. The £18.4m decrease, primarily used for markets monitoring project expenditure, includes the drawdown for the £7.3m impairment costs, detailed in table x.4

Regulatory Reform

To date, the Regulatory Reform Programme has under spent its budget by £2.4m which will be used to reduce 2013/14 fees. The remaining £2.6m budget for this programme will be incurred in 2013/14.

Financial Management and Reporting Framework

This financial management and reporting framework explains the basis on which the FSA has managed and reported on its costs and funding to 31 March 2013. This framework will continue to be used by the FCA from 1 April 2013 to:

- exert sound financial management and budgetary control over all areas of expenditure and income; and
- seek to manage any unavoidable volatility to minimise the year on year impact on fee payers.

Ongoing Regulatory Activity (ORA)

These are core operating activities, managed year on year as part of the budget process. The cost of ORA is the key figure, along with the explanation for any material movements which demonstrates how we have met the obligation to be economic and efficient in using resources.

Changes in Scope

Under certain circumstances, including legislation introduced by Parliament, there may be changes to the scope of activities that are regulated. Any scope changes are subject to financial management as part of the budget process. However until a new supervisory process is established, material activities resulting from a scope change are controlled separately so they are individually identifiable. When the new supervisory requirements of the scope change have stabilised, typically after the new scope has been in place for at least a full year, these activities will be included as part of the cost of the ORA.

External enforcement costs

Total enforcement costs, managed within ORA, depend on the number of cases and their complexity. Because of the nature of enforcement cases, actual case costs may be materially higher or lower than the budget set in advance of the financial year. If this happens any excess or reduction in costs from budgeted level will be reviewed and, if appropriate, any impact on fee payers will be phased over a three year period, subject to being able to maintain satisfactory reserves.

Panel costs

FSA 2012/13 ORA includes the costs of the Financial Services Consumer Panel, Practitioner Panel and the Smaller Business Practitioner Panel. These independent panels manage their own costs against budgets which are subject to our approval and funded through our fees. From 1 April 2013 the Financial Services Act 2012 requires the FCA to establish and maintain the following independent panels: the FCA Practitioner Panel, Smaller Business Practitioner Panel, the Markets Practitioner Panel and the Consumer Panel.

Office of the Complaints Commissioner

The complaints system, required by FSMA, will continue under the Financial Services Act 2012. From 1 April 2013 the Complaints Commissioner will deal with complaints about the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Bank of England (in respect of its oversight of banking clearing houses and payment schemes). The Complaints Commissioner controls his own costs against a budget which is subject to FCA approval and is funded through our fees. These costs are included within the cost of ORA.

Pension scheme deficit reduction contributions

The amounts required to fund pension liabilities over time are inherently variable as they depend on factors such as investment values and projects investment returns. There are plans in place to reduce our pension scheme deficit to nil over the ten year period to 31 March 2021. Every three years the Trustee carries out a scheme specific valuation (SSV) which is a detailed valuation using actual asset and liability details. A recovery plan is then agreed with the Trustees to close the funding gap. The next SSV will be carried out using data as at 31 March 2013.

Reserves

In line with the Treasury Management Policy the FSA kept cash levels at the equivalent value of six weeks of ORA. It is anticipated that there will be sufficient financial capacity within revolving credit facilities to meet any expenditure required to address unforeseen events. ORA reserves will be kept at +/-2%.

Financial Risk Management

In the ordinary course of business a regulator's operations expose it to a number of financial risks including credit risk, liquidity risk, inflation risk and the risk from the provision and management of a final salary pension scheme. The FSA/FCA have in place a risk-management programme that seeks to limit the adverse effect on financial performance by monitoring these risks and taking appropriate mitigation action where required. The Financial Services Act 2012 provides the power to make rules to levy fees to fund operations. In doing so it seeks to ensure that operations are conducted with due regard to economy, efficiency and effectiveness as well as seeking to minimise any unnecessary volatility in fees.

The Board delegated the responsibility of monitoring financial risk management to the Audit Committee. The policies set out by the Board of Directors are implemented by the finance function (concerning the manner in which transactions are accounted for, the overall management of financial risk and fee invoicing and collection).

Credit risk on the collection of our periodic fees

The FSA/FCA charge fees to the persons it authorise, the bodies it recognises, the companies it lists and the entities it registers. The consultation process the FSA/FCA through in order to set its fees is designed to help ensure that they are set at a level which both reflects the regulatory activity involved and is affordable to all fee payers, large or small. In addition, many of the smaller fee payers use facilities offered by Premium Credit Limited, an independent credit provider to finance the payment of fees. In such instances, Premium Credit Limited bears the credit risk rather than the FSA/ FCA. The level of unpaid debts is monitored regularly however the FSA/FCA's exposure to bad debts is minimal and is currently less than 0.3% of fees receivable.

Counter-party risk

The Board has approved a policy for the management of any surplus cash balances that we may hold above the level needed to meet our short term liquidity requirements. Such balances are invested by our agents, Lloyds Banking Group, in high quality, liquid deposits with a range of counter-parties in such a way as to avoid an excessive concentration of our investment with any specific counter-party. Funds are only deposited with firms that met minimum investment criteria as assigned by credit rating agencies.

Final salary pension scheme

The most significant financial risk is that the benefits the Pension Plan offers to its Final Salary members will not be matched by the assets available to the Plan. In that case, the residual cost will be met by the FCA. What is being done to manage those risks is set out in note 14 to the financial statements.

Currency risk

The FSA/FCA does not have any significant exposure to currency risk.