



CHOICE IN THE UK AUDIT MARKET

KEY POINTS FROM STAKEHOLDER MEETING HELD ON 10 MAY 2007 AT RSA LONDON

The Financial Reporting Council (FRC) held a third stakeholder meeting on 10 May 2007 as part of its 'Choice in the UK Audit Market' project. The focus of the meeting was on the interim report of the Market Participants Group ('the Group') that is advising the FRC on this project. The meeting was intended to assist stakeholders to develop their responses to the consultation over the Group's interim report and the discussion was based around the provisional recommendations in that report. Around 80 people attended the meeting.

Recommendations

Meeting participants asked questions and made comments on the provisional recommendations of the Group. The following points relate to the recommendations in general:

- The Group saw each of its provisional recommendations as complementary rather than competing. In addition, the recommendations, if confirmed, would be addressed to a range of different organisations. It has not, therefore, sought to prioritise the recommendations.
- The Group had set out to maintain Boards' absolute responsibility for auditor selection. It did not wish to restrict any Board's authority but did see a need to enhance the accountability of Boards for their auditor selection decisions.
- It would be important for the Group to obtain the views of companies and their boards on the interim recommendations. In meetings held by the FRC with chairmen of listed companies in 2006 the chairmen had expressed a degree of frustration and concern at the characteristics of the audit market. Companies were well represented on the Group itself and the interim report had been circulated to FTSE 350 companies.

The following points relate to particular recommendations:

- On recommendation 3, regarding policy on auditor liability arrangements, the Group had not considered in detail the case for audit firms to be required to hold minimum levels of capital.
- On recommendation 6, regarding access by the incoming auditor to information relevant to the audit held by the outgoing auditor, the Group's focus to date had been on the flow of information between the audit firms rather than between the company and its new auditor.
- On recommendation 8, regarding information on auditor selection policies and decisions, this information could form a useful starting point for improved engagement between shareholders

and boards, although there was also a risk that boards could become more cautious in their auditor selection practices.

- On recommendation 9, regarding the disclosure by Boards of restrictions in their choice of auditors imposed by third parties, it was noted that restrictions might be imposed through loan covenants in order to increase the perceived value of the loan for trading purposes. In addition, restrictions that were made prior to any contract being made might not be visible from the loan agreements themselves.
- On recommendation 10, regarding investors developing good practices for engagement on auditor selection, the Group did not have particular practices in mind and was keen to hear from investor groups.
- On recommendation 11, regarding reviewing auditor independence rules which may have a disproportionately adverse impact on choice, providing greater flexibility to Boards on ensuring their auditor is independent might help lead to constructive engagement between investors and companies.
- On recommendation 13, regarding the development of protocols for a more consistent response by regulators to audit firm incidents based on their seriousness, “regulators” should include other authorities with prosecution powers.

Next steps

The following points were made in relation to next steps of the Choice project:

- The Group would meet to consider responses to its consultation over the summer. It would publish its final recommendations as soon as possible although the exact timing was difficult to predict until the nature of the responses was known.
- The Group had not yet considered the appropriate timescale or success factors for implementation of its recommendations. It would be appropriate to do so once views on the interim recommendations had been received through the consultation.
- Although the UK is probably at a more advanced stage of debating the characteristics of the audit market, the subject was becoming of increasing interest in other major jurisdictions. There had been considerable interest amongst international securities and audit regulators, some of whom were at the stakeholder meeting as observers, in the work of the Group.
- In parallel to the work of the Group, the FRC was developing audit continuity plans to consider how regulators could respond to the possible loss of an audit firm. The primary responsibility for preparing for such an event would remain with company directors.