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Dear Sir

CONSULTATION ON PROPOSED CHANGES TO GUIDANCE ON AUDIT COMMITTEES (THE SMITH GUIDANCE)

We welcome the opportunity to comment on the proposed changes on the Smith Guidance (SG) arising from four of the recommendations of the Market Participants Group (MPG) and also from the 2007 review of the Combined Code.

1. Do you agree with the proposed changes based on MPG recommendations? If not, please explain and, if possible, suggest how the proposed changes could be improved. (page 10)

We support the proposed changes but have the following suggestions for their improvement.

The proposed SG 4.22 requires the audit committee to explain to shareholders how it reached its recommendation to the board relating to the appointment, reappointment and removal of the external auditor. The proposed SG 5.2 makes clear that this explanation should be given in the audit committee section of the annual report.

Certain of the existing requirements in the Smith Guidance for explanations (4.9, 4.17 and 4.32) are taken from the Combined Code (Section C3). Listed companies that do not comply with those provisions are required by the Listing Rules to give the reasons for non-compliance. We consider that the proposed SG 4.22 should be included in the Combined Code so that the "comply or explain" principle would be directly applicable.

SG 4.22 proposes an explanation of any contractual obligations that acted to restrict the audit committee's choice of external auditors. We noted in our response on the Interim report of the MPG - April 2007, that whilst we welcome such a proposal we believe that the transparency needs to include reference to influences that arise before the contractual stage. It is often the inclusion of a clause in a draft agreement (which may subsequently be



removed), or a reference in a letter or a conversation, that influences an entity not to appoint a non "Big 4" firm.

2. Do you have comments that will assist the FRC in finalising the impact assessment? (page 12)

The draft impact assessment notes that the change that could involve extra costs is the audit committee explanation of how it reached its recommendation to the board on the appointment, reappointment and removal of the external auditors (proposed SG 4.22). However the Combined Code already has a requirement that "The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors." Thus the additional proposal is merely that the audit committee explains how they reached that recommendation.

The draft impact assessment notes "The possible cost of putting the audit out to tender in order to assuage possible concerns of some shareholders, although the MPG considered that companies would only need to incur the cost of putting their audit out to tender when they judge that a change of auditor could be beneficial." However that cost exists irrespective of the proposed changes. The proposals do not require a tender to be made; they merely make clear when such an event last occurred.

We note that a number of users and preparers were supportive of the proposed disclosures as set out in MPG recommendation 8. In finalising their impact assessment the FRC should consider not just the cost implications but also the benefits of the additional disclosures.

If you would like to discuss any of these comments, please contact Andrew Buchanan at 020 7893 3300.

Yours faithfully

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