



CMB/BLC-SUB/mb

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Dear Mr Hodge

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

The Business Law Committee is the Institute's committee which monitors developments in the rules and regulations affecting businesses generally and considers legislative and other proposals deriving from bodies such as BERR, the FRC, the FSA and the European Commission. The Committee is broadly based, with members representing different sizes of accountancy practice, industry, the investment community, and the legal profession.

ICAS supports the work undertaken by the FRC in raising the matter of limited choice in the audit market for listed companies and the drive to maintain and improve audit quality.

We note that the consultation paper addresses four recommendations put forward by the Market Participants Group in its October 2007 report, namely:

- MPG recommendation 8 - The FRC should amend the section of the Smith Guidance dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor selection decision.
- MPG recommendation 9 - When explaining auditor selection decisions, Boards should disclose any contractual obligations to appoint certain types of audit firms.
- MPG recommendation 12 - The FRC should review the Independence section of the Smith Guidance to ensure that it is consistent with the relevant ethical standards for auditors.
- MPG recommendation 15 - Major public interest entities should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.

Our comments regarding the above consultation paper are as follows.

Paragraph 4.19 *‘and consideration of audit firms’ annual transparency reports, where available’*

The change proposed will help to guide audit committees to ask for and review transparency reports, which may be a useful source of readily available information. We have currently some reservations, however, that such material may be used as a marketing tool rather than a governance statement. We look forward with interest to the outcome of the Audit Firm Governance Working Party and its development of a code of best practice.

Paragraph 4.21 new *‘The audit committee should assess periodically the risks associated with the possible withdrawal of their external auditor from the market and consider whether any mitigating action is appropriate.’*

Many PLCs have considered a risk plan since the demise of Andersen. However, the FRC may wish to provide guidance on what would be an appropriate mitigating action in these circumstances.

Associated planning is also required by the FRC to develop a framework in which audit expertise and public entity audits can be transferred in an orderly manner to other remaining market participants in the case of a major firm withdrawal.

Paragraph 4.22 new *‘The audit committee report should explain to shareholders how it reached its recommendation to the board on the appointment, reappointment and removal of the external auditors. This explanation should normally include*

- *Any contractual obligations that acted to restrict the audit committee’s choice of external auditors*
- *When the audit was last subject to tender, and*
- *When the current group auditor was appointed.’*

It is important that any new proposals are only implemented if they will add value. Further information and transparency may be of interest to shareholders but the provision of such information is time consuming, expensive, and can simply lead to requests for further information. There should be trust between shareholders and their board and further disclosure is not necessarily appropriate in all situations. We question whether there is a need for this new disclosure requirement and it should be remembered that a shareholder can request this information at the AGM. If this recommendation is implemented we do not think it is necessary to include the latter three bullet points.

Paragraph 4.24 onwards - *amendments to ensure consistency with ethical standards.*

We agree with the need for consistency between the ethical standards and the Smith guidance.

Paragraphs 2.3 and 2.4 – *changes to reflect possible Combined Code amendments*

As we noted in our response to the Combined Code consultation concerning the possibility of a company chairman sitting on an audit committee for smaller companies, this relaxation may be helpful to smaller companies outwith the FTSE 350. There is the question, however, of whether it is appropriate to have separate provisions for different size companies or whether the Code should state the principles and thereafter any non-compliance should simply be explained by the company. We would prefer principles based guidance that is applicable to all companies without any carve outs.

Please do not hesitate to contact me should you wish us to expand on or to discuss further any aspects of the above points.

Yours sincerely

A handwritten signature in black ink that reads "Charlotte Barbour". The signature is written in a cursive, flowing style.

CHARLOTTE M BARBOUR
Assistant Director, Accounting and Auditing