



**KPMG LLP**  
8 Salisbury Square  
London EC4Y 8BB  
United Kingdom

Tel +44 (0) 20 7311 1000  
Fax +44 (0) 20 7311 3311  
DX 38050 Blackfriars

Chris Hodge  
Financial Reporting Council  
Fifth Floor, Aldwych House  
71-91 Aldwych  
LONDON  
WC2B 4HN

Our ref tc/815

4 June 2008

Dear Chris

### **Consultation on proposed changes to Guidance on Audit Committees**

We welcome the opportunity to comment on the FRC's proposed changes to the Guidance on Audit Committees (The Smith Guidance).

Except as set out below, we agree with the proposed changes to the Smith Guidance set out in Section Two of the consultation document.

#### Proposed new paragraph 4.22

MPG recommendation 8 regarding increased transparency around the audit selection decision attempts to address proposed paragraph 4.22. It proposes that the audit committee section of the annual report should explain to shareholders how the audit committee reached its recommendation to the board on the appointment, reappointment and removal of the external auditor. We welcome this recommendation, but consider the draft recommendation totally misses the key factor in auditor selection which is the audit committee's assessment of audit quality. It mistakenly focuses instead in its specific disclosures on the rotation of auditors – 'when the audit was last put out to tender' and 'when the current group auditor was appointed'.

The auditor selection decision – and therefore the explanation to shareholders – should focus on the importance of audit quality and the process adopted by the audit committee in assessing the effectiveness of the audit process along with the qualification, expertise, resources and independence of the external auditor. Audit committees are quite capable of evaluating audit quality (within the FRC's Framework – Drivers of audit quality) and holding their auditors accountable for the performance of their professional duties. In future they will also have the periodic reporting of the AIU to assist them.

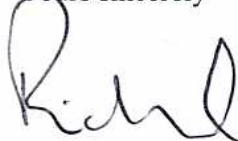
Frequency of audit tender is not a key determinant of audit quality and therefore should not be a major factor in the audit committee's decision making process. Indeed studies have shown the reverse – it is the early years of an audit that are most vulnerable to errors being made. Increasing the frequency of audit tenders is likely only to increase costs and distractions for already busy audit professionals at the expense of time available to spend enhancing audit quality, let alone the distraction to management in running an audit tender process.

Finally, to ensure consistency with the section on 'communication with shareholders', we suggest replacing "the audit committee report" in paragraph 4.22 with "the audit committee section in the annual report". Within the unitary board system, the board as a whole should be responsible for these disclosures.

Draft impact assessment

We have no comments on the draft impact assessment.

Yours sincerely



Richard Bennison  
Partner, UK Head of Audit