

**From:** [Jonathan Hayward](#)  
**To:** [Standard](#)  
**Subject:** Consultation on proposed Audit Committee Standard - response by Independent Audit Limited  
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Dear Madam

This email sets out Independent Audit Limited's comments on the FRC's proposed Audit Committee Standard. Independent Audit limited is a leading reviewer of board and committee effectiveness, with many years' experience of working with audit committees in FTSE350 companies and other public interest entities. We do not undertake financial statement audits.

1. The consultation paper says that audit committees should "follow [the Standard] on a comply or explain basis for now. This should hopefully help to smooth the transition to the Standard when the necessary legislation is passed." There are a number of difficulties with shifting to a Standard from the existing basis, which is more than just "comply or explain".
2. The underlying basis of the present system is principles-based, with the UK Corporate Governance Code setting out the objectives of good governance (the Principles) as well as describing the ways of achieving those objectives which might normally be expected (Provisions). It is only the latter which is subject to comply or explain. The Principles are not negotiable – companies are expected to achieve those objectives – but the means by which this is done may vary.
3. The proposed Standard has largely shifted from being a principles-based statement of objectives that audit committees are expected to achieve, to being a list of specific requirements with which they must comply. This is partly by virtue of it being defined as a Standard which in due course will not be subject to comply or explain, and partly because it is compiled as a list of requirements with relatively little emphasis on objectives.
4. Experience in regulated sectors such as financial services is that a shift from principles-based to rules-based regulation does not lead to an improvement in outcomes. The proposed Standard can be expected to lead to audit committees being advised on compliance by regulatory lawyers whose interest in good outcomes is focused on protection of the audit committee.
5. As currently proposed, the Standard would result in a confusing mix of principles-based and rules-based regulation, which is not merely unhelpful on its own terms, but would encourage a continuing shift from the former to the latter. This is not a development that would enhance either the effectiveness or the attractiveness of the UK approach to corporate governance.
6. The section "Oversight of Auditors and Audit" (paragraphs 15-21) contains requirements that have been extant for some years already. In our experience the introduction of these various requirements has not consistently resulted in significantly more rigorous audit committee activity than used to be the case. There is nothing in the proposed Standard or the consultation paper to indicate what might cause this to be different in future.
7. There is no description in either document of how the proposed Standard is to be enforced when it ceases to be subject to comply or explain. It is possible that enforcement might provide at least part of an answer to the point raised in the previous paragraph, in which case it would be helpful if it were to be spelt out.

8. A further possible, partial solution to this might lie in paragraph 4 regarding the audit committee's responsibility to "[report] to the Board and the members of the company on how it has discharged its responsibilities with respect to the external audit". Experience suggests that greater emphasis on the scope and quality of external reporting will over time lead to a more thoughtful approach to the oversight requirement which is being reported. It would therefore be desirable for the proposed Standard to make explicit an increase in expectations regarding external reporting of Audit Committee activity.
9. It would also be helpful if information about enforcement could clarify how it will apply to a body of corporate governance regulation which is part principles-based and part rules-based, and whether any steps will be taken to reduce the likelihood of a drift into a compliance culture.
10. Paragraph 14 deals with the possibility that some eligible audit firms might be unwilling to tender for an audit, and suggests actions for the audit committee. These suggested actions have a Canute-like quality to them; it is difficult to imagine them actually making any real difference. The fact is that audit firms are commercial organisations that seek to optimise their own risk/reward positions. Appeals to virtue such as asking them to consider how such action is in the public interest are unlikely to overcome this. Threats such as reminding them that they might as a result be ineligible to bid for non-audit services will often be empty, except perhaps in extreme circumstances where there are no or very few firms willing to tender for audit. Most often, it will be in the company's interests to maintain relationships with well-qualified potential suppliers for non-audit services.
11. There are indeed significant problems relating to lack of choice in the audit market. This is a complex issue that can put the interests of individual companies and audit committees at odds with the wider public interest. The defective system needs to be addressed by Government and regulator(s) dealing with the root causes of the issue, not by attempting to make audit committees give priority to the public interest over the interests of the companies and shareholder for whom they act.

Yours faithfully

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