

**From:** [REDACTED]  
**To:** [Standard](#)  
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Dear Susan,

I have provided some comments below on the Draft Minimum Standard for Audit Committees.

Kind regards,

Steven Hansen

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## **General comments**

I have provided some comments on the draft standard below, but in my view you should completely re-think your approach, re-draft it, and re-issue a new draft for consultation alongside an impact assessment.

I do think all the elements we need from a standard exist across this draft, your three existing guidance documents, and the legislation. Issuing a standard is an opportunity to bring all of that together into a single, coherent, and easy-to-understand document.

The draft standard uses imprecise language and does not define key terms. This means it is very difficult to establish what difference it would actually make in practice.

The tone is that of a guidance document, not a standard. The only minimum requirement (i.e. "must") is "*the tendering process must not preclude the participation of "challenger" audit firms without good reason*" therefore it is not obvious how the FRC/ARGA would enforce this standard as written. I think that rather than taking the text from existing FRC guidance and codes and you should write a proper standard with precise, mandatory, and enforceable requirements.

As you note in the consultation document, legal obligations for audit tender processes already exist. I think the standard should be built around those obligations by providing a consolidated plain English description of the law, with clear references to the actual legislation. If the standard were to be written in that manner an entity would be able to comply with your standard and know that they also comply with the law, without having to trawl through the Companies Act 2006 and the Audit Regulation. Setting the legal requirements out in the standard would also provide a route for the FRC/ARGA to enforce them via its standard, rather than remedy for defective appointments coming from the default power of the Secretary of State set out in section 486A of the Companies Act 2006.

Embedding the current law into your standard would also mean that those requirements will persist if the *Retained EU Law (Revocation and Reform) Bill* results in the deletion of the current requirements. I think that Article 16(3) of the Audit Regulation contains good requirements and these should be retained in UK law/regulation despite Brexit.

I think it would then be helpful if, after setting out the legal background, the standard then went on to explain the minimum that must be done to apply some of more nebulous legal concepts in practice. In particular, the following concepts in Article 16(3) of the Audit Regulation would benefit from further explanation:

- The minimum necessary for tender documents to allow the auditor to "*understand the business of the audited entity and the type of statutory audit that is to be carried out*" (16(3)(b)).
- the factors that must be included within "*transparent and non-discriminatory selection criteria*" (16(3)(b)).
- The minimum content of a "*a report on the conclusions of the selection procedure*" (16(3)(e)).

I also think that the three existing guidance documents “*Best practice guide to audit tendering*”, “*Audit quality – practice aid for Audit Committees*”, and “*Guidance on Audit Committees*” should be combined into a single guidance document. This could be an appendix to the new standard so that an entity only has to look in one place to find both the minimum they are required to do, and examples of best practice that go beyond the minimum. By combining the documents you would reduce duplication across your publications and make them easier to maintain.

## **Comments on the draft Standard**

I have set out some comments on the draft text, but please note that I do not think that fixing the issues I describe below will fix the problems I describe above. I think the standard should be completely re-written to be grounded in the legal requirements.

### Defined terms

The standard should, at a minimum, define the following terms: “audit firms”, “non-audit relationships”, “external auditors”, “financial statements”, “non-audit services”, “Public Interest Entities”, “executive management”, “engagement partner”, “‘challenger’ audit firms”, “independence (of a potential auditor)”, “conflict of interest”, “Big Four”, “quality”, “challenge”, “technical competence”, “price”, “cultural fit”, “overseas regulators”, “audit quality indicators”, “final presentation”, “necessary expertise”, “price-blind tender”, “eligible audit firms”, “high-quality audit”, “sufficiently high standard”, “annual audit plan”, “effective oversight”, “annual report”, “significant issues”, “accounting policies”, “certain matters”, “regulatory inspection”.

If these terms are imported from other standards or legal obligations then the standard should provide clear references.

### Scope and authority

The UK Corporate Governance Code operates on a “comply or explain” basis rather than being a requirement. It is not clear how this standard would apply, if at all, to a company that does not have an Audit Committee, or has a committee that does not have the required terms of reference. I think that the standard should either:

- apply to the company’s directors (but allow delegation to an appropriately constituted committee); or
- require the directors to establish an Audit Committee that is capable of carrying out the requirements of this standard.

Whilst I recognise you are targeting FTSE 350 companies because that is what the government’s response to its White Paper consultation concluded the standard should do, I do not think it would be appropriate for a company to be able to avoid the requirements of the standard by operating in a manner that excludes them from the FTSE 350 index, for example by being a private company or listing on a different exchange. The standard should instead apply to all UK Public Interest Entities, as defined in law.

The standard should have an effective date. You mentioned 2023 financial year ends in your podcast. That seems very early given the consultation does not close until 8 February 2023 and so I would not expect the final standard to be issued until we are well in to 2023. I think you should defer the effective date to 2024 at the earliest, and provide some transitional relief for tender process already in progress when you publish the final standard.

I agree the standard should apply immediately when a company comes in to scope, but you might consider some transitional provisions, such as allowing a tender process that is in progress to complete if re-starting the process would leave a company without an auditor.

### Responsibilities

Audit committees are not subject to the UK Corporate Governance Code. Some companies are required under the Listing Rules to report in their annual report and accounts on how they have applied the Code. I think the standard should be clear about the authority it has, and from where it is derived.

It is unclear if this standard is requiring companies to give their Audit Committee the responsibilities set out in the “Responsibilities” section.

The standard should explain what “the need for greater market diversity” is, how an Audit Committee can determine if the need is met, and what their minimum obligations are in respect of this aim.

The standard should explain what “market opening measures” are, who has the power to introduce them, and where they are published.

## Tendering

It is unclear if *“Public Interest Entities (PIEs) are currently required to put their audits out to tender every ten years, and to rotate auditors every twenty”* is a requirement imposed by this standard, or if the standard is simply cross-referencing other obligations. If the standard is cross referencing other obligations it should do so precisely.

For paragraph 6, the Audit Committee should be permitted to make use of employees throughout the group, if applicable, not just the entity. In general, I also think the standard should say more about what an audit committee must do in relation to subsidiary companies; there is a whole ISA about group audits that the auditor must follow, so it would seem appropriate for the company’s Audit Committee to give that aspect of the audit some special consideration.

The standard should define the term “challenger audit firm” and explain how an Audit Committee determines whether a reason for excluding one from participation is a good one.

Ensuring that companies have a sufficient number of potential auditors that are independent, or capable of becoming so, in order to allow for adequate competition and choice in a subsequent tender is not something that is solely within the control of an individual entity’s Audit Committee. The standard should more clearly set out the minimum that the Audit Committee, specifically, must do to support this aim.

The standard should explain what the minimum requirements of transparent and non-discriminatory selection criteria are. If paragraph 9 are those minimum requirements then the standard should make that clear. The standard should explain what an Audit Committee must do if no auditor meets the selection criteria.

The standard should explain the minimum standard of “involvement throughout the tender process” in paragraph 10.

In paragraph 11, the standard should set out the minimum requirements of a tender process rather than the “typical tender process”. The standard should define the minimum amount of choice that would satisfy the requirement for sufficient choice, or at least explain what is meant by the term “sufficient”.

Paragraph 11 includes a requirement on “companies”; the requirement should be re-phrased to be one that applies to the Audit Committee.

The standard should explain what an Audit Committee should do if there is only one, or no, audit firm options available for the purpose of paragraph 12. I also think that the standard should not prevent an Audit Committee from presenting more than two options to the board, although in accordance with s.485A(5)(a) of CA2006 the committee should, as a minimum, state its first and second choice.

It is not clear what *“The Audit Committee should also consider asking those firms how such action is in the public interest”* means, or what the Audit Committee is expected to do with the firms’ responses to that question. This obligation may be better placed on the FRC/ARGA, and perhaps implemented through your Audit Market Supervision functions.

*“The Audit Committee should remind eligible firms that refuse to tender that they may as a result be ineligible to bid for non-audit services work.”* is not an appropriate requirement to impose on an Audit Committee and I am very surprised that you are proposing to interfere with how companies choose to procure services that are outside of your regulatory remit. If the FRC/ARGA wants to force audit firms to tender for audits then they should include that obligation in the Auditing Standards or Ethical Standards for Auditors, rather than, effectively, requiring FTSE 350 companies to create blacklists.

## Oversight of auditors and audit

External audit is not a “public interest function”. As set out in ISA (UK) 200, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. If the FRC/ARGA wants to alter the scope and responsibilities of auditors it should do so through the Auditing Standards, or the government should do so through legislation.

The standard should set out what a “sufficiently high standard” of audit is, and the minimum steps the Audit Committee should carry out to understand if the threshold is met.

## Reporting

It is not clear whether “the annual report” in this context is a standalone report published by the Audit Committee, or intended to mean that this information should be included in a company’s annual report and accounts. If the FRC wants to create new minimum requirements for a company’s annual report I think these should be included in the accounting standards, or introduced via a new FRS that addresses all narrative reporting matters in the “front half” of an annual

report.