Draft Minimum Standard for Audit Committees

LSEG RESPONSE TO FRC CONSULTATION

February 2023

Introduction

LSEG is a leading global financial markets infrastructure and data provider, trusted to deliver excellence by customers, partners and markets around the world. We play a vital social and economic role in the world's financial system. With our trusted expertise and global scale, we enable the sustainable growth and stability of our customers and their communities.

We operate across three divisions:

- **Data & Analytics**. Delivering data-driven insights, indices and products to customers simply and flexibly so they can make better-informed decisions.
- **Capital Markets**. Supporting customers across the end-to-end capital markets workflow, providing them with access to liquidity across multiple asset classes and regions. We are a leading provider of listing and execution venues in equities, fixed income, and foreign exchange. The London Stock Exchange, our UK-regulated market, remains the most international market in the world, serving over 2,000 equity issuers that are headquartered in over 100 countries; £278bn has been raised for equity finance in London Stock Exchange's market over the past ten years. Since its launch in 1995, over 4,000 companies have joined AIM, our market for growing companies, have raised over £132bn in growth capital.
- **Post Trade**. Supporting customers' clearing and reporting obligations, providing risk and balance sheet and financial resource management solutions, and working with our other divisions to extend this support across the value chain. We operate a group of leading multinational clearing houses, with clearing operations in the UK, the Eurozone, the US and an expanding presence in the Asia Pacific and Latin America. LCH is our leading global clearing house. LCH operates in 62 participating countries, with over 800 buyside customers, 150 member banks and over 50,000 end users.

Given the role that strong corporate governance frameworks play in supporting economies in which companies are well-run, LSEG welcomes the opportunity to respond to the FRC's consultation on an Audit Committee Standard which follows the Government White Paper Restoring Trust in Audit and Corporate Governance.

Executive Summary

Overall, LSEG broadly supports the production and principles of the Draft Minimum Standard for Audit Committees.

However, the balance of the Standard is sub-optimal. We believe there is currently too much emphasis on the tender aspect of an Audit Committee's responsibilities – a once a decade event – and insufficient detail on day-to-day or year-to-year matters, including overall audit quality and oversight of the audit.

The Standard doesn't provide sufficient detail on what the Audit Committee should expect to see/receive from an external auditor over the course of the year. If this is the Standard that Audit Committees should be held to, it is important to have some guidance on what Audit Committees should expect to get from the auditor (i.e. providing more colour than might be in the Code for example). This could cover:

- The contents of an audit plan
- Split of audit between substantive and control based
- View on internal controls
- Alternative Performance Measures
- Climate-related reporting
- Audit differences
- Fee analysis

We believe the Standard should include more guidance on how Audit Committees should assess an auditor's performance, including what criteria, audit quality indicators and benchmarking should be used. The Standard should also include guidance on what an Audit Committee should do under certain circumstances – for example, that it can change the lead audit partner if the audit/partner/team is not performing to a good enough standard, or that it can call a tender early.

Given our comments above, we believe there would be value in the FRC reworking the draft Minimum Standard and subsequently reverting to consult stakeholders again on a revised draft Standard.

Scope and Authority

We support the proposed scope and authority of the draft Minimum Standard – namely, that it will apply to Audit Committees of companies with a Premium Listing on the London Stock Exchange, and which are included within the FTSE 350 index.

Responsibilities

We broadly support the responsibilities of the Audit Committee relating to the external audit.

However, with regards to paragraph 4, we do not believe there should be an expectation or requirement for an Audit Committee to engage with the entity's shareholders over external audit work. Shareholders will not be sufficiently close to the level of information that auditors, management and audit committees have to be able to advise appropriately on this topic. Ultimately the external auditor determines the scope of their work, not the Audit Committee.

Tendering

We make the following comments regarding the section on Tendering.

<u>Tendering processes</u>

In the first instance, we believe that an Audit Committee Chair, rather than the Audit Committee as a whole should lead the tendering process. It may not be feasible or practical for the full Audit Committee to be involved in all elements of the tender process – for example reviewing the slate of proposed audit partners, and interviewing them.

Furthermore, for large firms, it is generally not feasible for an Audit Committee to negotiate the fee. In practice, this responsibility will generally fall to the management team (or its procurement team) to conduct the negotiations, with the Audit Committee giving final approval on the fee to be paid.

With regards to paragraph 7, while we agree that there is "a strong public interest in audit market diversity and the market as a whole having sufficient resilience, capacity and choice", we do not believe that it is the responsibility of an Audit Committee to ensure adequate competition and choice. That belongs to the audit markets and audit firms themselves. We would therefore recommend the deletion of the words: "in order to allow for adequate competition and choice in a subsequent tender".

Price blind tenders

With regards to Audit Committees running ‘price blind tenders’, while a price blind tender is appealing in theory, a key consideration in practice should be the amount of hours (and split of resource by seniority and location) that an audit firm commits. This is paramount to assessing audit quality. On this basis a price blind tender may not be advisable as price is driven by hours and charge out rates (and there is unlikely to be much difference on charge out rates). In any case, we question how practical it is for an Audit Committee not to consider price at all when selecting an external auditor. In our experience as a business, as well as a market operator, we see this is as highly unlikely.

We believe a more appropriate approach would be making sure that criteria for assessing each auditor are clear and that these criteria include a much larger weighting towards audit quality.

Eligible firms refusing to tender

We recommend removing the sentence – “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.” We believe individual engagements (whether audit or non-audit) should be assessed on their own, independent merits.

Managed shared audits

As we wrote in our response to the Government’s White Paper, “Restoring trust in Audit and Corporate Governance, we do not support managed shared audit requirements for UK-registered FTSE 350 companies. We believe they will ultimately lead to higher costs with little benefit in overall audit quality.

Given that the Government has confirmed that FTSE 350 companies will be required either to appoint an auditor outside the Big Four or to allocate a certain portion of their audit to a smaller firm, we believe it is important for it (that is, the Department for Business, Energy and Industrial Strategy) and the FRC to work closely with the affected businesses to clarify how they will be expected to balance audit quality, including independence, challenge and technical competence, with the need to allocate some activities to smaller firms selecting an auditor.

Oversight of Auditors and Audit

We agree that the external audit is a critical public interest function. We therefore generally support the section regarding the oversight of auditors and the audit. We would however encourage the FRC to be clearer on what it means by ‘external sources’ which are not investors (as stipulated in the final bullet of paragraph 16).

Reporting

We broadly agree with this section although would make the following comments.

<u>Accounting policies</u>

We would encourage the FRC to further clarify what it means when it suggests that the "annual report should describe the work of the Audit Committee" in the context of "the application of the entity's accounting policies". The application of accounting policies is covered extensively in the back half of the annual report and therefore more clarity on what the FRC is actually proposing (potentially including examples) would be helpful.

<u>Shareholder engagement</u>

As we have noted earlier, we do not believe that it should be a requirement for an entity to consult shareholders on what should be included in an audit. As such we do not believe it is necessary to report on where a shareholder request has been rejected. We believe this remains the case even if an entity voluntarily consults external shareholders. For example if the shareholder request reflects a basic misunderstanding, or is frivolous, it serves no purpose reporting this in the annual report.

<u>Regulatory inspection</u>

With regard to the fourth bullet point in paragraph 22, we would welcome further clarity on whether any regulatory inspection would be specific to the company's audit or more generally on the external audit firm.

With regards to paragraph 24, we believe that it should be sufficient for the Audit Committee to report on whether it believes it has met the requirements of the Standard, not to have to explain what it has done to do so. This would be akin to the 'comply or explain' approach that is used in the UK. Having to report on these activities in the context of the standard risks being repetitive and creating unnecessary reporting as key points will have been covered elsewhere in the Audit Committee report.

LSEG