Financial Reporting Council

Financial Reporting Council

Minutes of a meeting of the Board of Directors of the Company held on 15 January 2019 at the FRC, 8th Floor, 125 London Wall, EC2Y 5AS

PRESENT:	Sir Winfried Bischoff	Chairman
	Gay Huey Evans	Deputy Chairman
	Mark Armour	Non-Executive Director
	Sir Brian Bender	Non-Executive Director
	David Childs	Non-Executive Director
	Olivia Dickson	Non-Executive Director (by phone)
	Paul Druckman	Non-Executive Director
	Nick Land	Non-Executive Director
	Keith Skeoch	Non-Executive Director (by phone)
	Mark Zinkula	Non-Executive Director (by phone)
IN ATTENDANCE:	Mark Babington	Deputy Director of Audit Policy
	Helen Grimshaw	Senior Economist, Head of Strategy & Analytics
	Mike Suffield	Acting Executive Director, Audit & Actuarial Regulation
	Truda Scriven	Interim Board Secretary (notes)
APOLOGIES:	John Coomber (comments sent by email)	
	Stephen Haddrill	
	Julia Unwin	
	Jenny Watson	

1 QUORUM AND OPENING OF MEETING

1.1 The quoracy of the meeting was confirmed by the Chairman who opened the meeting.

2 DECLARATIONS OF INTEREST

2.1 There were no other declarations of interest not already registered.

3 INTRODUCTORY REMARKS

3.1 The meeting had been called to discuss whether the Board wished to make a submission to the CMA on their interim report by 21 January 2019.

3.2 A paper for discussion had been circulated by the Deputy Director of Audit Policy. Members commended the paper as a well-formulated basis for discussion.

3.3 The discussion was conducted in the context of the Kingman report having been published. It proposed a more powerful regulator with additional powers that could be used to achieve better systems of quality control and greater consistency in the audit market.

3.4 The CMA update report centred on the issue of competition in the audit market.

3.5 It was agreed to make a formal response and that it should be concise and focus on outcomes and deliverability.

4 DISCUSSION

4.1 There was a wide-ranging discussion with the following matters raised and agreed.

4.2 A detailed analysis was required of the critical mass of the so-called 'challenger' firms and their ability and wish to compete including: resources, geographical spread, sector capability and capacity. It was recognised that even if two challenger firms consolidated, they would still fall significantly short of the scale and scope of any of the Big Four. Therefore, greater competition would not be automatic through this route.

4.3 Currently the Big Four were well-capitalised, high quality firms with global reach. They had harnessed this profile to transform the market. But consistency of quality was a key issue for them.

4.4 Joint audit is a medium to long term remedy – likely to be over five to ten years – the success of which depends on the desire and capacity of challenger firms to take on additional FTSE 350 audit engagements. A number of other countries which had experienced joint audit had subsequently abandoned it (Denmark, Sweden and Canada). The French example provides a case study for mandatory joint audit being implemented in practice, but even there, the Big Four firms still earn 85 per cent of total audit fees from the largest listed audit clients. There is also no clear evidence that the model used in France has had a positive impact on audit quality and it would therefore be useful to develop a stronger evidence base. It was noted that the market share cap remedy would pose significant short-term risks to quality and competition.

4.5 Intensifying competition was not an automatic prelude to delivering quality.

4.6 An analysis of which audits could be divided in a way that would not result in poorer quality would be helpful to inform the CMA's final proposals.

4.7 An authorisation regime operated by the new (ARGA) regulator, which assessed the capabilities of challenger firms, could be considered. Such a regime could be used to inform the judgement of audit committees when recommending the appointment of audit firms to shareholders.

4.8 A global coalition of regulators would achieve more than a UK regulator alone if some more far-reaching remedies were to be considered. This had been achieved in the financial services sector.

4.9 Under the existing Directive, the FRC was required to monitor the effectiveness of audit committees. The FRC should more strongly develop a mechanism within this framework. Audit committees are required to both assess audit firm capability at tender and thereafter, to evaluate how competently the audit had been carried out. The new regulator would be well-placed to make a judgement on the basis used for audit firm appointment and to report on it. This would be particularly relevant when the FRC took on the regulation of PIE audit firms which could be coupled with an authorisation regime. Audit committees should answer shareholder questions at AGMs.

4.10 The potential benefits of using a SOX-style approach in the UK were recognised including assurances offered by a disclosure committee.

4.11 It was unclear how a peer review approach to audit could be made to work and have public confidence. It was felt that a more invasive and pervasive regulatory approach to all the components of an audit (including management and audit committee) could offer a solution.

4.12 There was some discussion of how a ringfencing environment could best utilise the expertise (e.g. cyber security and tax) in the consultancy arms of audit firms and deal with the complexity of transfer pricing. Consideration should be given to the effect on resilience of audit firms if financially independent.

5 CONCLUSION

5.1 It was agreed to draft a submission that (in the post Kingman context) drew on the proposed core competences of the new (ARGA) regulator. This response could anticipate the regulator's future position and support CMA's approach to securing resilience in the market.

5.2 The response should consider the CMA's proposals against the criteria set out in the report:

- address the underlying audit quality concerns;
- can be implemented, monitored and enforced effectively;
- are proportionate to the scale of the issue; and
- consider the potential risks and unintended consequences.

5.3 The submission should make clear the Board's view that a joint audit approach could only effect greater competition in the medium to longer-term and should ask that the CMA address the risks which led some other countries to move away from joint audit.

5.4 A ringfenced operational split could be achieved. However, fee increases, and additional capital may be required to secure resilience if financial independence was suggested by CMA. CMA should be asked to consider the principle of financial independence in the context of resilience of the market.

5.5 The linkages between the CMA, Sir John Kingman and Sir Donald Brydon reports should be identified and co-ordinated.

6 NEXT STEPS

6.1 A draft response would be prepared and circulated to board members for comment by the end of the week. The final version would be circulated to board members. It was assumed that the response would be made public.

FRC Chairman