



8 February 2023

Financial Reporting Council
8th Floor, 125 London Wall
London EC2Y 5AS

Via email: acstandard@frc.org.uk

For the attention of Susan Currie.

Dear Ms Currie,

Consultation: Proposed Minimum Standard for Audit Committees

Background

The CRUF welcomes the opportunity to respond to this draft standard, which seeks to implement government decisions emanating from both the CMA, on widening choice in the audit market, and the 'Restoring Trust' agenda.

On competition, the CRUF has consistently said that audit quality must have priority, while accepting the case for a more resilient audit market. On "Restoring Trust", we look forward to legislation that will create the ARGA and give it the power to hold directors to account for their corporate reporting and audit-related duties. To help it do this we support the setting of minimum enforceable standards in key areas – and the appointment and oversight of auditors is one of these.

Beyond this, the question is to what extent mandatory standards should be set for audit committees (ACs), or for the board more generally, and to what extent the FRC/ARGA will continue to rely on the Corporate Governance (CG) Code and best practice guidance. The problem with the non-mandatory approach is that the good comply and the bad do not. We look forward to the FRC clarifying the proposed approach ahead of ARGAs creation.

We note that the proposed standard only covers a fraction of an AC's work. It does not refer to proposed reforms that users of accounts consider just as important: the audit and assurance policy; directors' statements on resilience and fraud detection; disclosure of distributable reserves. We look forward to proposals for minimum standards on these. Nor does it refer to the AC's main responsibilities as set out in the CG Code, including monitoring the integrity of the financial statements, reviewing significant financial reporting judgements, providing information necessary for shareholders to assess the company, and reviewing internal financial controls and risk management. In the absence of a UK version of the Sarbanes-Oxley Act, we are keen to hear how the FRC/ARGA might enforce a minimum standard on the last of these.

Our response

We have four overarching points:

1. Significance of this draft standard

It is early days for the FRC/ARGA as a standard setter (it has focused on the production of codes and guidance). CRUF members have noted that the standard does not cover the majority of an AC's responsibilities. Other potential governance standards are likely to cover the audit & assurance policy, and directors' statements on resilience, identifying fraud and distributable reserves.

The CRUF suggests renaming the standard to reflect its limited scope. If it is the first of a suite for ACs, eg "Audit Committees S1: a minimum standard for audit tenders and oversight of the external auditor"; if it is one of several future governance standards, eg "CG S1: a minimum standard for audit tenders and oversight of the external auditor".

As, potentially, the first governance standard for ACs/boards, the way it is framed and set out matters. Models suggested by CRUF members include:

- Auditing standards/ISA (UK)s with (using ISA (UK) 240 on fraud as a base) an intro, objectives (or purposes), definitions and requirements and then a section on other explanatory materials;
- Something similar to the ISSB's S1 in terms of format.

2. Purpose/objective

An introductory paragraph could set out the overarching purpose and the objective of this standard. The SEC, for example [Final Rule: Audit Committee Disclosure], says:

Audit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditors' participation in the financial reporting process ... [They] promote investor confidence in the integrity of the financial reporting process.

As a specific objective, the CRUF suggests:

The purpose of the minimum standard is to provide a base for audit committees in overseeing the tendering and management of the external audit contract. This includes:

- Take in the bullet points from Par 4 "Responsibilities"

3. Scope

Par 1 states that the Standard is applicable to all UK incorporated companies with a Premium Listing on the London Stock Exchange and which are included within the FTSE 350 index.

The CRUF believes that AC Standard(s) should ideally cover all public interest entities (PIEs) (however defined – we note the "restoring trust" proposed definition of companies with more than 750 employees and £750m of turnover). For LSE-listed companies, the standard should apply not only to the premium segment but, bearing in mind the FCA's proposal to combine premium and standard listing rules, to all main market companies. The scope of the standard should be at least the same as for the Corporate Governance Code. A general point is that the different definitions of a PIE are causing confusion.

4. Structure

There is an issue with guidance (sometimes vague and wordy) being translated into a compulsory standard. The CRUF believes the distinction between mandatory requirements and best practice guidance should be very clear. It suggests that the standard should be more mandatory in form and tone. Hence the suggestions above that it should follow the structure of auditing or accounting standards. It could cross-refer to guidance documents on tendering or AC practice, or there could be an appendix carrying other explanatory materials. Either way, mandatory actions need to be crystal clear.

Detailed comments on the draft standard

Scope

Par 1: See above. The scope of the standard should be at least the same as for the Corporate Governance Code. Ideally it should cover all PIEs, however defined.

Par 3: The legal requirement to tender every 10 years applies to PIEs – companies listed on a regulated exchange plus unlisted banks and insurers. The legislation already includes some specific requirements. The standard could (phased in) become mandatory for PIEs under the government's proposed new definition: more than 750 employees and £750m turnover. The size criterion has the advantage of pulling in private companies that are of public interest, reducing the regulatory gap between public and private markets. It would also ensure larger companies listed on Aim were in scope.

Responsibilities

Par 4:

- Bullet point 1: What is a “fair choice”? The existing rules say at least two options should be submitted to the board. This implies that a longer list should be considered by the AC. (See comment on pars 7, 11 and 12).
- Bullet point 3 – “where appropriate, engaging with shareholders on the scope of the external audit”. The words “where appropriate” are too vague. The CRUF would prefer:

“The AC should engage with investors on the scope of external audit.”

Collecting views from those with a financial interest in the company provides an opportunity to discover concerns that the external auditor should address.

Tendering

Pars 7, 11 and 12: These are all related to the “fair choice” issue. “A sufficient number” is vague. Par 12 endorses the current requirement for two options to be put to the board. Par 11, in suggesting three or four as “typical” might discourage initial consideration of a larger number. Should the

requirements go further? For example, a larger minimum number for either the board or the AC to consider in a long list? These three pars could be combined and made more concise.

Par 9 on the criteria for the choice of auditor is key, CRUF welcomes the emphasis on quality, including independence, challenge and technical competence, rather than on price or perceived cultural fit.

Reviewing audit quality indicators could be a separate point. We suggest expanding the last line to include 'and any other source'.

Par 10: As this will add to the AC's workload, it would be helpful to say (in explanatory or guidance notes) why this should be mandatory, eg to ensure factors other than technical financial expertise are fully considered; eg to allow a longer list of candidates to be considered.

Par 13 The Audit Committee should run a price-blind tender.

Par 14 This is an example of text that reads like guidance notes rather than a mandatory standard. The important point is that the AC should find out why eligible firms are not taking part in the tender. This will enable it to explain to the board and externally why only two firms were considered. Other text could be cut and placed in guidance notes with a cross-reference.

Oversight of auditors and auditing

Par 16 is the most important in this section. The introductory sentence could be simply:

"The Audit Committee should obtain evidence of the effectiveness of the external audit and the auditor."

Why limit the seeking of evidence to "those impacted by the audit/auditor", especially as the bullet points rightly range more widely?

The bullet points cover procedural requirements well.

- Bullet points 2 and 5: the auditor's response to FRC inspections and reviews is very important. These points could be combined and Par 19 could be wrapped in too.

Last bullet point on feedback. The CRUF suggests:

The AC should ask the auditor to gather and feed back to it any views on corporate reporting issues that might be material, qualitatively as well as quantitatively, to investors.

Reporting

Par 22 bullet point 2 on accounting policies should be more specific, e.g.

The AC should state what the key accounting policies are, notably those where management judgement has the most significant impact on the reported numbers.

Last bullet point: Again, the wording is vague. The CRUF suggests:



A description of non-audit services provided by the auditor; an explanation of why the auditor was regarded as best placed to carry them out; and how objectivity was safeguarded.

If there were a more general standard on AC disclosures, here are some suggestions:

- Details of members' backgrounds and relevance to AC work;
- Number of hours spent on AC both in and out of meetings (not just number of meetings per annum);
- Key agenda items/risks identified and how they were mitigated; risks outstanding – ie something analogous to the key audit matters section of the auditor's report.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations depending on their area of interest or expertise. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. Also, it would not be correct to assume that nonparticipants agree with the initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held in the UK and provided by participants in drafting the response. Differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer or other organisations they are a member of or associated with. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective employer or other organisations. The participants in the CRUF that have specifically endorsed this response are listed below.



Signatures

Jane Fuller

Jeremy Stuber

Charles Henderson

Sue Milton

Peter Parry

Masayuki Kubota