APPENDIX 1

Remedy 1: Mandatory tendering

26. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) What an appropriate time frame for requiring mandatory tendering might be, given the bounds suggested above?

As discussed in our letter on remedies, we would support a maximum period between competitive tendering, as you have suggested, of between five and seven years. We believe the period should be aligned with the maximum tenure of the AEP thus if this is to remain at five years this would be a suitable tendering interval.

(b) Whether and for what reason the measure may be subject to 'comply or explain' implementation?

We would favour mandatory tendering with derogation able to be sought in exceptional circumstances from the listing authority and/or shareholders in a vote. A short list of generally acceptable reasons for postponing the tender should be developed by the listing authority following consultation with companies and firms.

(c) **How a valid 'tender' and its constituents should be defined, including whether and how best to provide access to relevant information on an 'open book' basis?**

As discussed in our letter on remedies, we have reservations about the practicality of an 'open book' approach.

We consider tenders should be open in the sense that FTSE350 companies should indicate in advance that they are planning to put their audit out to tender and should invite initial expressions of interest such that when it wishes to start the tender process it should provide all those firms which have expressed an interest with details of the initial tender asking for preliminary submissions which would probably best focus on technical issues and would probably not be expected to include the proposed fee. Once the tender responses have been received back a shortlist should be prepared and the shortlisted firms asked to present to the audit committee.

The FRC should work with professional bodies, companies and firms to develop a framework for tenders and rotation with a view to enhancing the efficiency and effectiveness of audit tenders and of switches between firms.

(d) What costs and benefits would arise as a result of this remedy?

The costs would be those for the companies and firms associated with organising and participating in a tender. Given the very few competitive tenders currently taking place, as discussed in our letter, we believe the costs would be significantly outweighed by the benefits so long as tenders are fair as well as regular. They would contribute to the creation of a more competitive market in which audit committees and shareholders are regularly able to make an informed choice as to their preferred auditors.

(e) What should be the requirements for phasing in this remedy? For example, those companies with the longest period since last tender may be required to tender first within a specific period.

We would recommend phasing in over a period not exceeding, say, five years, with those who have not tendered for the longest time being required to tender first under the new arrangements.

(f) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

We believe it is essential that all firms which believe they have the necessary capabilities should be allowed to submit a proposal to a FTSE350 company undertaking a tender. In addition, there would be merit, in considering, at least for a transitional period, a requirement that at least one firm from outside the Big 4 firms should be included on the shortlist.

Guidelines should be drawn up, as discussed in our letter on remedies, on procedures for undertaking an effective tendering process.

<u>Remedy 2: Mandatory rotation of audit firm</u>

34. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) What an appropriate time frame for requiring mandatory rotation might be, given the bounds suggested above and how this might relate to mandatory tendering periods if this were also to be pursued?

As discussed in our letter on remedies, we would support a mandatory rotation period normally of 15 years, subject to derogation or significant extension in the event a company appointed joint or major component auditors. The proposed period would allow up to two intervening tenders between mandatory rotations. We consider that three consecutive terms before rotation seems sufficient.

(b) Should any such measure be subject to a waiver from the regulator (FRC) if a company's choice of auditor was substantially constrained and how would such a waiver operate?

We believe it would be more appropriate for any waivers to come from the listing authority or BiS and should be exceptional and only permitted after all options have been explored, eg use of joint or major component auditors.

(c) How a valid 'tender' and its constituents should be defined as a prelude to rotation, including whether and how best to provide access to relevant information on an 'open book' basis?

We would not expect the tender process to be significantly different whether it was being held at a time when mandatory rotation was required or on an occasion when the existing auditor was eligible for reappointment. We have discussed above our preferred approach to tendering.

(d) What costs and benefits would arise as a result of this remedy?

In addition to the normal costs associated with a tender, in circumstances where there is mandatory rotation there will always be a change of auditor and so the costs of 'educating' the new firm and additional costs to the firm in the first year of a new audit need to be taken into account.

We believe that the benefits would outweigh the costs if tendering were linked to joint and major component audit in the manner we suggest as there would be significant benefits, of the kind outlined in our letter on remedies, from having a vibrant competitive market meeting shareholders' needs and which was fully operating in the public interest.

(e) What should be the requirements for phasing in this remedy? For example; those companies with the longest period since last rotation may be required to rotate first within a specified period.

As for the new approach to tendering, we believe this remedy should be phased in over a period of approximately 5 years with companies whose auditors have been in place for the longest time being subject to this requirement ahead of those where the first appointment of the incumbent is more recent.

(f) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

For any other relevant issues, please see our cover letter on remedies.

Remedy 3: Expanded remit and/or frequency of AQRT reporting

41. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) **How the AQRT's remit should be designed in terms of enhanced scope and frequency. For example;**

(i) **How frequently should FTSE 350 company audits be reviewed (and whether this should differ between FTSE 100 and FTSE 250 companies)?**

The question is whether the focus should be on the companies or the firms. Until now it has primarily been based on the firms with a selection of their clients reviewed. We believe more work is needed before deciding a change from this approach is necessary though a merit of a switch to a focus on companies would be to create a more level playing field for firms as the Big 4 firms have a far smaller proportion of their audits reviewed than is the case for other firms subject tot AQRT review.

If one were to focus on the frequency with which companies are reviewed, one might expect the largest FTSE100 to be reviewed about once every three years, the rest of the FTSE100 at 5-yearly intervals and FTSE250 companies about once every 7 years. We recognise that if such a shift were to take place there would be significant additional costs in respect of the AQRT process which would need to be borne by the firms and ultimately shareholders.

(ii) **Should the AQRT be required to publish FTSE 350 results separately from other Public Interest Entity results?**

We would see merit in AQRT results being published separately in view of their role in the economy.

(iii) **Should the AQRT be required to change the scope of its review and if so, how? For example; should the AQRT be required to revisit key audit judgements based on the information then available?**

It seems hard to just reviewing with hindsight as opposed to reviewing the reasonableness of the decisions made with the knowledge available at the time as this, by definition, would seem to go beyond the concept of review. The whole area of AQRT reporting, and more broadly the audit regulatory system, needs to be reviewed to see whether it is playing its full part in enhancing audit quality. There is a view that it has led to an improvement in documentation rather than in the quality of judgement. Significant additional resource has been devoted to the regulatory process in recent years and it would be helpful to assess the outcomes resulting from it.

(iv) **How could AQRT reporting be expanded to allow better comparison of Big 4 and non-Big-4 firms?**

It is not necessarily so much about just reporting but about making sure AQRT staff is drawn from different backgrounds in terms of size of firm. It is also important that there is a proportionate approach with regards to size of company whose audit is being reviewed as smaller FTSE250 companies

will be just a fraction of the size and complexity of the largest FTSE100 companies and will be resourced accordingly.

On reporting, the audits reviewed are not necessarily a representative sample of the firm's work and this needs to be borne in mind in assessing the results. Care needs to be taken not to slip into an over simplistic league table approach in reviewing the findings on individual audits.

(b) How should any expanded remit of the AQRT be funded?
We would include this issue within the widespread review of auditing regulation which we have proposed above. It would need to be clear that any additional benefits from an expansion of AQRT outweighed the additional costs.

(c) What costs and benefits would arise as a result of this remedy?
Again, we would look at this issue as part of the widespread review which we have proposed above. The costs are principally the time of the audit firms and the financial contributions made to the cost of AQRT. The benefits are potentially those arising from a higher level of audit quality than would otherwise be present

(d) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?
Consideration needs to be given to ensure that this remedy does not create an additional barrier to entry in the FTSE350 market in terms of how audit firms not currently auditing FTSE350 companies are perceived and assessed by the companies and the wider market.

Remedy 4: Prohibition of contractual clauses in template documents limiting choice to the Big 4 firms

45. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) The range of documents to which this prohibition should be imposed and how the prohibition could be best implemented. For example: are there documents in addition to Loan Management Association lending agreements that this prohibition should cover?
We are not aware of any other specific documents but it should be clear that formal and informal attempts to limit tenders to just Big 4 firms are not acceptable. This would include identifying them by characteristics even if not by name.

(b) What costs and benefits would arise as a result of this remedy?
The costs should be minimal. The benefits would be those arising from removing one source of institutional bias although we do not think this remedy of itself will have significant marketplace impact.

(c) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?
We do not have further comments to make on this section.

Remedy 5: Strengthen accountability of the External Auditor to the AC

52. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) **How this remedy could be practically specified and implemented? For example, what change to ACC availability and remuneration would be necessary for ACCs to take on an enhanced role effectively? How should this measure be specified to avoid circumvention?**
As discussed in our letter on remedies, the main change needed with regards to audit committees is for greater dialogue between audit committee chairs and institutional investors. More regular tendering and mandatory rotation is likely to naturally lead to ACCs being more involved in decisions relating to the appointment and reappointment of the auditor. That said, there is a role for the CFO to be involved as the lead executive in this area in liaising with the audit team on a day to day basis.

If significantly increased time is needed from the ACC for some FTSE350 companies some adjustment in remuneration may be needed and each board should consider whether this is the case for them.

(b) **Whether this remedy could be implemented as an extension to the current guidance on the role of the AC? How this could be implemented without affecting the current collective legal obligations of the directors of a company?**
This remedy could be implemented through appropriate changes to both the UK Code on Corporate Governance and the related Guidance for Audit Committees.

(c) **What costs and benefits would arise as a result of this remedy?**
Some increase in the time commitment of ACCs and the costs associated with this increase. There may also be some increase in audit costs. The benefits will be those arising from reducing the risks of a principal/agent problem arising.

(d) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**
We have no further comments to make on this section.

Remedy 6: Enhanced shareholder-auditor engagement

57. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

(a) **What are considered to be the most effective means of enhancing shareholder engagement on audit and financial reporting issues?**
A combination of enhanced audit reports, regular and fair tendering, mandatory rotation, the real possibility of joint and major component audits, better disclosures of links between board members and auditors/potential auditors and the possibility for shareholders to consider two candidates for appointment as auditor will together provide institutional shareholders with the necessary information and involvement necessary to have a constructive conversation with the auditors.

(b) **Suggestions as to how such means could be achieved**.
The above can be a achieved by a mixture of action by the Competition Commission; FRC issuing, in conjunction with IAASB, a revised auditing standard on reporting and by amending the Stewardship Code; and by company board members, auditors and shareholders investing the necessary time to foster effective dialogue.

(c) **What costs and benefits would arise as a result of this remedy?**
The principal costs would be those arising from the extra time of shareholders and auditors in fostering dialogue and that from implementing the other remedies highlighted.

The benefits would be the substantial ones arising from a more competitive audit market better focused on meeting investors' needs and serving the wider public interest.

(d) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?
We have no further comments on this section.

<u>Remedy 7: Extended reporting requirements – in either the AC's or the auditor's report</u>

64. Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

***(a)* How the CC may best support the FRC in establishing enhanced reporting and whether there are other avenues, including direct measures by the CC, that should also be pursued?**
The CC should ensure the necessary changes are implemented in the appropriate manner. It should be very cautious about accepting voluntary and/or 'comply or explain' initiatives as they are unlikely to yield the necessary changes.

(b) **What should be the scope and form of enhanced reporting proposals? For example:**

(i) **whether further disclosure should be made via the AC's report or the auditor's report**
There is scope for enhancement to both reports. The AC's report could be enhanced with a commentary on material or relevant judgements made in preparing the financial statements. The auditor's report could be enhanced with a commentary on the key assessments made in the course of the audit, including in relation to the AC's report.

(ii) **what the content of the additional disclosure should be. For example, should this be some form of commentary as to how the company's interpretation of the accounting standards compares with the norm; or commentary on the main topics of debate between auditor and management; or something else; and**
One would expect how the choice of accounting policies compared with industry practice to be on of the areas of discussion between the auditor and audit committee.

The new edition of the UK Corporate Governance Code includes additional items expected to be included in audit committee reports and there is a related auditing standard covering reporting by the auditor on linked issues. We do, however, as discussed, believe additional reporting is needed of the links between the board and the auditor and other potential auditors.

(iii) **what guidance as to the form of the disclosure should be required**?
We would envisage this primarily being dealt with by the FRC through its UK Code on Corporate Governance, its Guidance for Audit Committees and auditing standards.

(c) **What costs and benefits would arise as a result of this remedy?**
There is likely to be some additional time spent in discussion between the auditors and the audit committee together with the time and related costs associated with preparing the relevant material.

(d) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**
We do not have any further points to make on this section.

88. **The CC invites views on all these possible remedies which we are not minded to consider further and on any other possible remedies that we have not included in this Notice which interested respondents consider may be effective in addressing the AEC we have provisionally found. Where respondents are of the view that these remedies could be effective, they are asked to submit evidence to support their views and in particular provide views of the costs and benefits of the measures and any other relevant factors that they consider significant to the evaluation of the measures in addressing the AEC we have provisionally identified.**

We have proposed in our main letter that you should also consider limitations on the provision of non-audit services by the auditor and the requirement or encouragement of joint/major component audits as well as disclosure of links between the board and the auditor and other potential auditors.

Our letter on remedies discusses why these are needed which can essentially be linked to reducing the barriers to entry facing new firms seeking to enter the FTSE350 audit market.

The benefits are an enhancement in quality through a reduction in independence/perception of independence concerns in the case of limiting the provision

of non-audit services and through the enhancement in quality resulting from the ‘four eyes’ principle in the case of joint audit.

More generally, we believe significant benefits would be derived from the emergence of a more innovative and competitive market, more responsive to the needs of the shareholders.

In terms of costs, we do not envisage any in the case of limiting non-audit services. On the contrary, we expect that this will result in more competitive fees for non audit services.

Major component audits should lead to a saving of costs as a result of introducing new firms and creating a more competitive market.

We would estimate a modest increase in time costs (of no more than 5% which would generally be borne by the audit firms) as a result of appointing joint auditors against which needs to be set off potential cost savings for companies and shareholders from creating a more competitive market and the quality benefits discussed above.

90. **Views are invited as to whether any particular combinations of remedy options would be likely to be effective in addressing the AEC we have provisionally found. Views are also sought as to whether there are any particular combinations of remedies which are likely to interact adversely in reducing effectiveness or otherwise lead to undesirable outcomes**.

We consider our proposed nine remedies (your original seven and our two proposed additional ones discussed above) would, if appropriately designed, interact positively with each other.

Unless tendering is fair as well as regular, given the institutional bias that exists in the market there is a danger that it will just lead to the Big 4 firms further consolidating their position rather than challenger firms gaining market share.

93. **Views are invited on the nature, scale and likelihood of any relevant customer benefits within the meaning of the Act and on the impact of any possible remedies on any such benefits.**

We believe a more innovative and competitive market with additional players would bring substantial benefits to shareholders in terms of quality, innovation and fee levels as well as an enhanced range of providers and would lead to the public interest being better served.