22 March 2013

Non-confidential version

Annex 3

Response to Remedies Notice

In section 3 of our Response we have set out our position in respect of the package of remedies that in our view would work in combination to improve the functioning of the audit market and address the concerns identified in the PFs. We have also explained why certain remedies proposed by the CC are unnecessary or would be disproportionate to the AECs identified.

In this Annex we respond to each of the questions as set out in the RN on the seven remedies being explored by the CC, as well as briefly confirming why the CC is right not to pursue certain other remedies.

Remedy 1: Mandatory tendering

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

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

(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?**

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

(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 specified period.**

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

1 We do not support this remedy for the reasons we set out in section 3 of our Response: mandating that tenders take place in any given year (be that 10, 7 or 5 years) is not necessary to increase the frequency of tenders, is not in companies' best interests and is disproportionate to the CC's aims.[1]

2 The new tendering regime devised by the FRC can be expected to lead to a sea change in the approach of companies to tendering the audit and we believe the CC should allow time for the impact of this change to be observed before requiring any further changes to the tendering regime.

[1] Paragraph 23 of the RN sets out the CC's aims as being (a) to encourage more frequent tendering and increase the possibility of switching, increasing companies' bargaining power and the incentives for auditors to compete; (b) to provide greater opportunities to mid-tier firms to tender; and (c) to reduce the incentives of auditors to compete to satisfy management rather than shareholder demand.

3 We welcome measures to improve the effectiveness and efficiency of the tender process and we would support guidance from the FRC to companies on how to conduct an effective and efficient tender process. However, we do not consider that requiring "open book" tendering is appropriate and we do not support the introduction of such measures for the reasons set out in paragraphs 3.34 to 3.36 of section 3 of our Response.

Remedy 2: Mandatory rotation of audit firm

(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?

(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?

(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?

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

(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

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

4 We do not support mandatory rotation for the reasons set out in detail in section 3 of our Response. This is a materially more onerous measure than is required to meet the aims set out in the RN. Mandatory rotation would be detrimental to the market and produce disadvantages significantly disproportionate to its aim.

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

(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)?

5 It is important to maintain the independence of the regulatory regime and therefore we believe it is for the FRC to establish the appropriate scope of work that it (and/or the AQRT) should perform as part of its quality assurance activities.

6 However, we support enhancements to the role of the AQRT designed to improve the ability of ACs to assess audit quality. More frequent AQRT reviews of individual FTSE 350 audits would provide companies with greater insight into their own audit, as well as better facilitating comparison between audit firms.[2]

7 If the frequency of AQRT reviews were to increase, it is likely that some change in the AQRT's review process would be required to ensure the AQRT process as a whole remained timely[3] and cost effective. For example, an increase in the number of inspections from the current rate of 15-20 per annum per firm to a rate of 30 or more would be disruptive if the review process were unchanged, and would inadvertently risk damaging audit quality by diverting auditors unduly from carrying out the audit.

8 Any increase in frequency should be proportionate and balanced against the potential costs of doing so. We believe it is for the FRC, following consultation with appropriate stakeholders, to consider this further.

9 We see no reason to distinguish between FTSE 100 and FTSE 250 companies.

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

10 The way the FRC presents its results is a matter for their discretion. However, our view is that separating results of the FTSE 350 from other Public Interest Entity results would not necessarily facilitate like-for-like comparisons of audit firms and may potentially lead to the inspection results of individual audits being identifiable to the public. We believe it is likely to be of more benefit to companies when comparing audit firms to consider the inspection results for

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2 The current frequency of AQRT reviews are selected to some extent on a risk basis (i.e. a company's audit would be selected for review only once every specified number of years), rather than on a "time since last review" basis.

3 The AQRT's current reviews already involve a considerable time lag between the financial statement year end date of the audit and when the final findings are publicly reported (e.g. the results of an inspection for an audit carried out for a September 2011 year end will only be published in the public report in May 2013). Absent a significant increase in the AQRT's resources and embedding efficiencies in the review process, increasing the number of reviews is likely to place further pressure on timely reporting.

individual audit firms in respect of all of their Public Interest Entity audits inspected by the AQRT.

(a)(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?

11 The AQRT currently revisits key audit judgments based on the information available at the time of the original audit. It would be highly inappropriate for the quality of the audit to be assessed on the basis of information that could not reasonably have been known by the auditor when making audit judgements.

12 As outlined in paragraph 7 above, some change in the AQRT's review process may be required to ensure the AQRT process as a whole is timely and remains cost effective.

13 Changes in the AQRT's review process could take a number of forms, but we believe this should be determined by the FRC with appropriate consultation of shareholders, ACs, audit firms and other stakeholders, to ensure that any changes do not compromise the independence and value of the AQRT's reviews.

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

14 Currently, while the AQRT reports are useful indicators of quality for companies (and ACs in particular) to have regard to, there are some important limitations in terms of relying on them for comparison purposes:

(a) Most fundamentally, it is important to appreciate that the current AQRT inspection regime is expressly not designed to allow direct comparisons of audit quality across firms. The AQRT notes in its annual report that: "*We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements...Accordingly, our reports place greater emphasis on weaknesses identified requiring action by the firms than areas of strength and are not intended to be a balanced scorecard or rating tool* ."[4] [emphasis added]

(b) The FRC does not produce reports for individual firms other than those that audit more than ten entities within their scope (currently ten firms) and these are subject to annual or biennial inspections. Currently non-Big 4 firms are reviewed bi-annually whilst the Big 4 firms are reviewed annually.

15 We believe it is for the FRC to consider whether or not it is appropriate to change its reporting regime.

[4] FRC Audit Inspection Unit's "Public Report on the 2011/12 inspection of PricewaterhouseCoopers LLP", page 14.

(b) How should any expanded remit of the AQRT be funded?

16 Currently, FRC costs are passed on to the professional bodies (e.g. ICAEW), which in turn add on their own costs before passing the total on to the audit firms through a levy. Our view is that the current system of conducting budget reviews (and allowing audit firms and other relevant stakeholders the opportunity to comment) is the appropriate mechanism for the governance of budgets and costs.

17 We do not believe that refining the remit of the AQRT (for example to increase the number of reviews carried out per annum) should necessarily require an increase in the overall budget. We believe it should be for the FRC to conduct an impact assessment to inform the most appropriate inspection regime.

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

18 For the reasons set out in paragraphs 3.46 to 3.48 of section 3 of our Response, we believe benefits would flow from enhancements to the role of the AQRT designed to improve the ability of ACs to assess the quality of their company's audit, as well as the quality of competing audit firms.

19 However, this needs to be weighed against any increase in costs from modifying the inspection regime, both on the part of the AQRT and the time that audit firms spend in complying with such inspections. As explained above, our view is that this is a matter for the FRC, following consultation with the appropriate stakeholders, and after conducting an impact assessment of any proposed change to the inspection regime.

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

20 Notwithstanding the significant improvements made by the FRC in this respect, we believe that reducing further the time between the AQRT's inspection and the public report would be of great benefit to companies and ACs. As noted by the CC,[5] companies and ACs may not currently be seen to take any immediate action from public inspection results that recommend significant improvement. Since the issues may have already been discussed and resolved by the time of publication, it is our view that reducing the time taken to publish findings would further improve the perception of the inspection process.

21 Any acceleration of private reporting of findings to ACs would also be welcome – under the AQRT's current timings, planning for the next year's audit is likely to be well advanced by the time the AQRT reports to ACs.

[5] Paragraph 11.99.

22 Finally, we invite the CC to consider whether audit firms should provide companies with a greater quantity of relevant information to facilitate comparison among audit firms.

23 If all audit firms were to disclose certain information in their annual transparency reports, this would assist companies in comparing the quality of competing audit firms. Such information might include, as we already currently provide in our annual transparency reports[6] (but which is not consistent practice across the market):

(a) results of the AQRT's most recent review of the firm's audit engagements;

(b) information on the firm's international network and capabilities;

(c) details on the firm's quality monitoring programmes with regard to its UK firm and global quality review of its member firms;

(d) details on the firm's engagement quality control reviews and procedures;

(e) information on any performance indicators that are set by the firm and a report on improvements; and

(f) information on the firm's independence policies and the systems that are in place.

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

(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?

24 We support the removal of such clauses from all template contractual documents. Such clauses are not common in UK loan agreements and we are not aware of any template documents in addition to those produced by the Loan Market Association (LMA).[7]

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

25 We support the removal of these clauses because they would help to address the perception that mid-tier firms are being prevented from competing in the market. To the extent that such clauses are included in loan agreements relating to FTSE 350 companies or others with strong credit ratings, there is considerable freedom to amend them to suit the circumstances of the case, but removal of such clauses would improve any perception that they create a barrier for mid-tier firms.

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6 See our 2012 Transparency Report: http://www.pwc.co.uk/assets/pdf/transparency-report-2012.pdf

7 The CC refers incorrectly to the "Loan Management Authority" instead of "Loan Market Association".

26 The remedy should be relatively simple to implement and have low implementation costs. For example, the CC could make a recommendation to the LMA that they cease including such clauses in their template documents.

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

27 The CC may wish to consult providers of finance (as parties to such loan agreements) on the best ways to implement this remedy.

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

(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?

28 While in our experience there is a strong reporting line between the external auditor and the AC at the majority of large companies, we welcome measures designed to strengthen the accountability of the auditor to the AC. Therefore, in conjunction with the new FRC tendering regime, we welcome enhancements and improvements to the role of the AC, which has evolved over time to represent the interests of shareholders.

29 Our proposal is that the AC's role in auditor appointment and monitoring could be enhanced by:

(a) reinforcing that the auditor is accountable directly to the AC/ACC (on behalf of shareholders); and

(b) improving the nature and extent of the ACs' understanding of and involvement with the auditor's scope and plan, what issues the external auditor has identified during his or her work, and how these issues have been addressed and escalated (or not) during the course of his or her work (and where relevant how those issues are to be resolved). One way this could be carried out is by reinforcing within the existing audit standards the specific nature and extent of communications on these areas (discussed further below).

30 Such measures could be achieved by a combination of the FRC considering further appropriate guidance to ACs (pursuant to the Code) and by enhancements to International Standard on Auditing (UK and Ireland) 260 "*Communications with those charged with Governance*" (ISA (UK&I) 260). It should be noted that the FRC has already recently introduced extended reporting requirements for both auditors and ACs which increase the nature and extent of the matters that auditors are required report to ACs and extend the matters that ACs are required to address in their reports to investors.[8]

[8] See paragraph 4.32 of the FRC Guidance. See also FRC's response to the PFs, page 4.

31 We do not support the proposal for the auditor to be required to discuss all material issues with the ACC before raising them with the FD because we believe that this would risk impairing the auditor's current ability to access full information about the company. Any restriction of this nature would adversely affect audit quality. Further, provided the material matters were raised with the AC, this proposal would lead to a substantial increase in the time commitment required of AC members without significantly increasing their effectiveness.[9]

(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?

32 We believe it would be relatively straightforward for this remedy to be implemented as an extension to current guidance.[10] In relation to improving the AC's visibility of the auditor's work in particular, we note there are already requirements in the current auditing standards (particularly ISA (UK&I) 260) that specify the matters that auditors are required to communicate to ACs (and that require the auditor to consider whether there is a need to communicate these matters to the full Board). Compliance with these standards is already part of the AQRT's current inspection remit.

33 We do not believe it is advisable to be overly prescriptive on precisely what auditors are required to communicate to ACs and how they do so. The effectiveness of this remedy requires the AC to gain greater standing and recognition among the investor community. In our view, this is best achieved by expanding the range of issues that should be discussed with the AC; ensuring that management and shareholders understand that the AC is primarily responsible for the appointment and oversight of the auditors; and increasing the AC's visibility (through expanding the content of the AC's report and the role of the AC at General Meetings).

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

34 We consider that substantial benefits could flow from this remedy, particularly because it:

(a) provides a clear and effective line of accountability to the AC to counter assertions of undue management influence on the auditor;

(b) could be relatively straightforward to implement through changes to the FRC Guidance and to current auditing standards (particularly ISA (UK&I) 260); and

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9 Indeed, the FRC states: "*We are concerned with the practicalities of excluding the finance director from these discussions at an early stage. It is unlikely that an auditor will be able to determine whether a matter is an issue or not without detailed discussions with the finance director. Further we should like to explore whether the non-executives would be able to discharge this responsibility and whether the proposals as written threaten the principle of collective board responsibility. We would also wish to ensure that auditors do not lose sight of their responsibility to report to shareholders in the event that they remain concerned that matters have not been adequately resolved as a result of their reporting to and action by the audit committee*." (See FRC's response to the PFs, page 4).

10 This may take the form of UK extensions to the current ISA (UK&I) introduced by the FRC, or potentially global changes by the IAASB, depending on International developments, that would be adopted into the ISAs (UK&I).

(c) will ensure ACs are more involved in key audit matters.

35 There may be some costs associated with enhanced auditor reporting to the AC, depending on how the current guidance is expanded and specified. In particular, the CC should recognise that any increases in the AC's remit must also take into account that AC members are non-executive directors.

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

36 This remedy should be considered in the context of the overall package of remedies (see paragraph 62 below), which also includes greater auditor-shareholder engagement, additional reporting requirements, and an enhanced AQRT regime.

Remedy 6: Enhanced shareholder-auditor engagement

(a) What are considered to be the most effective means of enhancing shareholder engagement on audit and financial reporting issues?

37 We welcome measures for auditors to be directly engaged with and visibly accountable to shareholders.

38 Of the options proposed by the CC, the measures we support are:

(a) requiring the auditor to present to shareholders, for example, at the AGM on the conduct and outcome of the audit; and

(b) requiring the ACC to have a dedicated Q&A session, for example, at the AGM for the purpose of answering questions on the audit or financial reporting.

39 We believe these measures would supplement the ability of shareholders to make their views known regarding:

(a) auditor selection (following the company announcing its intention to hold a tender, as required by the Code); and

(b) the conduct of the audit (in accordance with shareholders' existing rights under the Companies Act 2006[11] and through representations made to the Senior Independent Director (SID), the ACC or to management).

[11] For example, section 527 of the Companies Act 2006 allows shareholders to send a request to the company requiring it to publish on its website a statement setting out any matter that the members propose to raise at the next AGM relating to the audit of the company's accounts (including the auditor's report and the conduct of the audit) or any circumstances connected with an auditor of the company ceasing to hold office since the previous accounts meeting.

40 We consider the other options set out in the RN to be less effective. In particular:

(a) We do not support changing shareholder voting requirements to include an option to vote for holding a tender. Under current arrangements, shareholders are asked annually at the AGM to approve the choice of auditor. If they do not give such approval, this is a clear signal to management that a tender process for a new auditor is required.

(b) Changing shareholder voting requirements could result in decisions being made based on votes by proxy voting agencies rather than investors with a direct interest in the company.[12]

(c) We do not agree with enhancing the level of support required for votes to reappoint the audit firm (i.e. beyond a simple majority), in circumstances where the company proposes that an incumbent auditor is retained after a tender. This is because:

(i) shareholders would not have the benefit of all the information from the tender process to support their decision – this has the potential to devalue the tender process that would have already taken place, leading to considerable and unnecessary uncertainty;

(ii) it could bias the voting towards minority shareholders acting to the detriment of the majority. Most AGMs are not representative of the entire capital base: in 2011 about 68% of the issued capital on average was voted at FTSE 100 AGMs[13] and so this would potentially give power to a vociferous minority of the shareholder base or a single large shareholder (as it would require significantly less than 25% of the total capital) to attend and vote against the resolution at the expense of the majority;

(iii) it makes the vote comparable to a special resolution by the shareholders (i.e. a majority of no less than 75%). It would be inappropriate for an annual decision on the choice of auditor to be in the same category of decisions as those requiring a special resolution, such as a winding up of the company.

(b) Suggestions as to how such means could be achieved.

[12] The FRC has already expressed concerns about the impact that such agencies are having on effective company stewardship (see the FRC's press release "*FRC publishes updates to UK Corporate Governance Code and Stewardship Code*" dated 28 Sep 2012: http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2012/September/FRC-publishes-updates-to-UK-Corporate-Governance-C.aspx). The 2012 Review of UK equity markets and long-term decision-making by Professor John Kay also found some companies were particularly critical of such agencies (see "*The Kay Review of UK Equity Markets and Long-term Decision Making*", paragraph 8.29).

[13] See page 1 of ICSA Registrars Group Guidance Note on "*Practical issues around voting at General Meetings*": http://www.esma.europa.eu/system/files/appendix_3_icsa_reg_grp_best_prac_genmtg_-_apr_2012.pdf

41 There are a number of legal and practical issues involved in the auditor presenting at a general meeting.[14] For example, it would be necessary for the auditor to have regard to the following when answering questions at a general meeting:

(a) confidentiality to the company: inclusion of wording in the audit engagement letter and/or the audit firm's terms of business to expressly exclude any breach of the auditor's duty of confidentiality to the company in circumstances where he/she is presenting to shareholders at the AGM, and is responding to questions from shareholders at the AGM; and

(b) duty of care to shareholders (as a body): inclusion of wording in the invitation to the AGM to make it clear that the auditor has the benefit of the disclaimer included in the audit report. Therefore, in presenting to the shareholders and in answering questions raised by individual shareholders he/she does not extend a duty of care beyond that which he/she owes to the shareholders (as a body).

42 It may be appropriate for the FRC to consider issuing guidance to ensure that these important issues can be addressed in an efficient and effective manner.

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

43 The costs of:

(a) requiring the auditor to present to shareholders at the AGM on the conduct and outcome of the audit; and

(b) requiring the ACC to have a dedicated Q&A session at the AGM for the purpose of answering questions on the audit or financial reporting are likely to be minimal.

44 This remedy would have benefits to the market because:

(a) there would be an enhanced line of communication between auditor and shareholder that is clear, direct and transparent;

(b) shareholders would be better informed about the audit process which would provide them with greater ability to assess audit quality; and

(c) this would be a relatively straightforward remedy to implement: auditors are already permitted to attend AGM's as are representatives of the AC and, whilst there are some steps to be taken to ensure that the auditor has sufficient protection in respect of his or her obligations of confidentiality to executive management, and protection from claims by individual shareholders, these could be dealt with relatively easily (see sub-question (b) above).

[14] We set these issues out in detail in our response to Q4 of the CC's hearing follow-up questions, dated 15 November 2012.

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

45 The relevant considerations relate to the protection of the auditor with respect to statements that he or she makes when presenting to shareholders at the AGM and in response to questions posed by shareholders at the AGM. We have set these out at sub-question (b) above.

Remedy 7: Extended reporting requirements—in either the AC's or auditor's report

(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?

46 We support the CC's proposed extension of reporting requirements to address unmet shareholder demand.

47 The FRC has already increased the requirements on AC reporting in its recent amendment to the Code. Further consultation on audit reporting is in progress by the FRC and, importantly, also by the International Audit and Assurance Standards Board (IAASB) as global consensus around the new auditor reporting model is important given the global nature of today's investors and capital markets. Both the FRC's and the IAASB's initiatives explore how the auditor's report can meaningfully provide further insight from the audit to meet the unmet demands the CC has identified. Both the FRC and IAASB have robust processes designed to ensure all stakeholders' views are brought to bear, with appropriate public interest oversight.

48 We would encourage the CC to support these consultations to find solutions to respond to the unmet demand. We do not believe that any additional direct measures are necessary.

(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

49 The FRC's Effective Company Stewardship recommendations took an important first step in extended reporting by asking ACs to describe in their reports the significant issues that the AC considered in relation to the financial statements and how these issues were addressed. The FRC's and IAASB's consultations will explore how the auditor's report can meaningfully complement the AC's disclosures with insights from the audit.

(b)(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

50 We believe that it is appropriate to work through the FRC's and IAASB's consultations to forge consensus on meaningful changes that can be made to auditor's reports to provide greater insight from the audit that can inform investors' understanding of entities' financial reporting.

51 We note that feedback from parties to the IAASB's June 2011 and 2012 auditor reporting consultations reconfirmed the fundamental principle that the auditor should not be the original source of factual data or information about the entity, and should not provide subjective views on positions or decisions taken by the company. Stakeholders were concerned that doing so would blur respective responsibilities and introduce uncertainty into the information used in the capital markets.

(b)(iii) what guidance as to the form of the disclosure should be required.

52 For the reasons explained above, we believe that the reforms to auditor reporting should be made through auditing standards and subject to the due process around them. Global consensus around the audit reporting model is necessary. The FRC's Consultation Paper provides a robust basis for the UK to both inform and influence the global debate through the IAASB.

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

53 We support greater transparency, and believe this remedy would bring benefits to shareholders and the wider economy in helping to foster trust in financial information and markets.

54 There will be some transition and quality control costs but, overall, the costs of this remedy should be comparatively small, as long as the issues in section (d) below are addressed.

(d) Are there any other relevant considerations to be taken into account in evaluating and implementing this remedy?

55 We support enhanced auditor reporting, but recommend that this is done through UK influence on the IAASB process rather than a separate FRC process. International harmonisation of auditor reporting will be more helpful to investors in global markets – as some of these issues extend beyond the UK.

56 Consideration of expanded reporting requires any legal restraints to be carefully addressed; for example, where companies have overseas listings and different legal considerations apply. It also requires careful treatment of confidentiality issues for both companies and auditors, and should not increase auditors' liabilities in terms of the additional information that the wider public may have regard to.

57 If a broader audit reporting model is to be implemented effectively, there may also be a need to explore appropriate safe harbours around the judgments that will necessarily need to be made regarding which insights to include, given the need to keep the auditor's report relatively concise.

Remedies the CC is minded not to consider further

(a) Constraining non-audit service provision by the auditor

58 We agree that the auditor should not face further restrictions on supplying non-audit services (NAS) on the basis that:

(a) Many changes implemented internationally have been designed to enhance independence and objectivity over the last decade, and there are extensive safeguards and systems already in place to protect and enhance this;

(b) The remedy would deprive both the auditor and the company of access to specialist expertise when required on complex audits;

(c) It would also reduce the choice available to companies in respect of NAS; and

(d) A cap on NAS fees would be inappropriate: it is impossible to determine independence by an arbitrary monetary amount, and the AC is best placed to decide what is in the shareholders' interest, given that when an AC is deciding whether the auditor should provide a particular service, it will consider many factors, including the overall quantum of services.

(b) Joint or major component audit

59 We agree with the CC that this remedy should not be implemented, for reasons including:

(a) Joint audits or major component audits[15] are likely to increase cost and complexity for companies, and could also adversely affect quality, with no evidence that they help mid-tier firms to expand. A requirement for joint audit appointments would damage the ability of the audit provider to take responsibility for the group audit statement, and would increase the likelihood of things "falling between" the two (or more) appointed audit firms. The need to appoint two audit firms and the complexities of liaising between the two firms would almost certainly increase costs. The almost complete absence of joint audits from the current UK market - despite there being nothing to prevent companies appointing joint auditors - reflects their unattractiveness to companies.

[15] "Major component audits" (or "shared audits") are where one firm signs the audit opinion, but relies on one or more other firms to audit parts of the group and "joint audits" are where more than one firm signs the opinion.

(b) Companies in the UK have long held the view that joint audits are sub-optimal and inefficient. Examples of companies that have moved away from joint audits include the Shell Group (in 2005) and BHP Billiton (in 2003). Other companies which had used two audit firms have subsequently changed to using a single firm: for example, TUI and Thomas Cook both switched to single audit arrangements.[16]

(c) Joint audits have been tried and abandoned in some countries because it adds to cost and reduces clarity of accountability and hence threatens quality. France is the only country in the world where joint audits are mandatory, other jurisdictions deciding such an obligation is not beneficial. In Denmark, which recently made this non-mandatory, companies chose to appoint single auditors.

(d) Joint audits can generally reduce choice (because they effectively create a single provider out of two providers, with potential spill-over effects into NAS).

(c) Shareholder group responsibility for auditor reappointment

60 We agree with the CC that this remedy should not be implemented. The FRC consultation on stewardship[17] identified a number of potential problems with this for investors and companies, including:

(a) confidentiality issues around enhanced reporting;

(b) risks that engagement with principal shareholders only would disadvantage other shareholders; and

(c) institutional shareholders may not see the need to be involved in such decisions.

(d) FRC responsibility for auditor reappointment

61 We agree with the CC that this remedy should not be implemented. In addition to the drawbacks the CC identifies, we believe this remedy would disenfranchise investors.

(e) Independently resourced Risk and Audit Committee

62 We agree with the CC that this remedy should not be implemented. As the CC notes, ACs already have the ability to procure independent advice on audit advice. We support the CC's view that strengthening the accountability of external auditors to ACs is a more cost-effective way of aligning audits with shareholders' needs.

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16 Both TUI (which was audited by KPMG and PwC) and Thomas Cook (which was audited by Deloitte and PwC) switched to single audit arrangements in 2008. TUI and Thomas Cook did not have "joint audits" in the sense of the auditors providing a joint statement, but used two auditors to cover discrete parts of their overall group audit requirement.

17 FRC "*Effective Company Stewardship – Enhancing Corporate Reporting and Audit*", January 2011.

Packages of remedies

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.

63 We have set out in section 3 of our Response how the combination of remedies we have described would improve the functioning of the market and address the AECs that the CC identifies in the PFs while avoiding detrimental and disproportionate adverse effects. It is essential to view this package of remedies holistically and not to assess each individual component in isolation. For example:

(a) empowering shareholders to take a more active interest in the audit (remedy 6), coupled with the enhanced role of the AC (remedy 5), where the ACC can be expected to take a more visible shareholder-facing role (remedy 6), underpins the new provision in the Code whereby ACs are incentivised to put audits out to tender on a regular basis;

(b) shareholder empowerment (remedy 6) will inform the AC as they make auditor appointment decisions (remedy 5) and encourage greater transparency around the process (remedies 6 and 7); and

(c) when reviewing their existing auditor and evaluating alternative firms, the AC (remedy 5) will have access to additional information about audit quality from the AQRT (remedy 3) as well from audit firms.

Relevant customer benefits

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.

64 We have explained in our covering letter and section 3 of our Response, in the context of mandatory rotation, that one of the features that the PFs find to give rise to an AEC is that companies and audit firms invest in a relationship of mutual trust and confidence from which neither will lightly walk away as this means the loss of benefits of continuity stemming from the relationship. The PFs expressly acknowledges that these benefits of continuity give rise to beneficial effects for customers (shareholders)[18]. As such, these effects must be taken into account by the CC in deciding on the appropriate package of remedies.

65 To the extent that companies are required to switch audit firms periodically, this would impose substantial costs on companies and force companies to give up the benefits of continuity. These detriments could be avoided by tendering under the new FRC regime, coupled with other remedies that strengthen shareholder engagement and AC effectiveness.

[18] Paragraphs 9.159 - 9.161.