



Governance *in brief*

Final report from the Competition Commission reinforces role of the audit committee

Headlines

- Audit committee responsibility for audit matters reinforced.
- New advisory vote on the audit committee report puts role of the Audit Committee Chair in the spotlight.
- Audit committees to be solely responsible for scope of audit and fees.
- Five year mandatory tendering proposal replaced with a ten year requirement.
- Enhanced audit quality disclosures required.
- Provides clarity in the UK for now, but EC position still uncertain.

The final remedies

On 15 October the Competition Commission published its final decision on remedies further to its inquiry into the audit market. There are a number with direct implications for audit committees:

Reinforcement of responsibility of audit committees for audit matters	<ul style="list-style-type: none"> • A stipulation that only the audit committee is permitted to: <ul style="list-style-type: none"> – negotiate and agree audit fees and the scope of audit work; – initiate tender processes; – make recommendations for appointment of auditors; and – authorise the external audit firm to carry out non-audit services. • The audit committee may establish a materiality threshold below which executive management may instruct the audit firm to conduct non-audit services.
New advisory vote on the Audit Committee Report enhances accountability of audit committee to shareholders	<ul style="list-style-type: none"> • There must be a shareholder vote at the AGM on whether the audit committee report in the company's annual report is satisfactory.
Mandatory tendering every ten years	<ul style="list-style-type: none"> • FTSE 350 companies must put their statutory audit engagement out to tender at least every ten years. • No option to delay tendering beyond ten years. • If circumstances could make tendering difficult in year ten then the Competition Commission is suggesting that companies tender earlier. • The Competition Commission's view remains that many companies would benefit from going out to tender every five years. If they choose not to, the audit committee should disclose when it next plans to go to tender and why tendering in that year is in the best interests of shareholders.
Increased frequency of the FRC's Audit Quality Review (AQR) team reviews and enhanced audit quality disclosures	<ul style="list-style-type: none"> • The FRC's Audit Quality Review team should review every audit engagement in the FTSE 350 on average every five years. • The audit committee should report to shareholders on the findings of any AQR report concluded on its company during the reporting period, stating the grade awarded and how both the audit committee and auditor are responding to the findings.

The other remedies are:

Prohibition of 'Big Four only' clauses in loan documentation	• Provisions in loan agreements which restrict a company's choice of auditor to certain categories or lists of statutory auditors should be prohibited, although parties may require that any auditor should meet objectively justified criteria.
The FRC to have regard to competition	• The FRC should amend its articles of association to include an objective to have due regard to competition.

Provisions which have not been taken forward

The review has now been concluded and the following potential remedies considered during the course of the inquiry are **not** taken forward:

- mandatory rotation;
- further constraining the provision of non-audit services by the auditor;
- joint or major component audit;
- shareholder group or FRC responsibility for auditor reappointment; and
- independently resourced risk and audit committee.

Timetable for implementation

It is expected that these remedies will come into force in the last quarter of 2014. We expect greater detail on transition arrangements will be given in the final report which is expected imminently (www.competition-commission.org.uk).

How this will sit with the other, existing requirements and proposals

Undertakings or orders are the primary means by which the Competition Commission's remedies are given effect under the Enterprise Act 2002. This means that the final remedies effectively 'trump' any pre-existing elements of the UK Corporate Governance Code, e.g. the ten year 'comply or explain' tendering provision, and so the FRC is likely to amend the Code in due course to bring it into line with these new requirements.

While the CC's final report does now provide clarity for the UK audit services market, the position in Europe remains unclear. The consequences of this are uncertain, as is how the UK and EU will work together to establish common ground. However, it is hoped this will be clarified in the next year.

Applicability to AIM companies

These requirements apply to the FTSE 350 premium listed companies. Therefore, AIM companies are not impacted by today's announcement.

Deloitte view

- The audit committee's role and accountabilities have been considerably enhanced which will lead to greater transparency of the audit process, enhancement of audit quality and greater transparency and disclosure in audit committee reports.
- Shareholders will have greater information to enquire into judgments and enhance their stewardship activities – it will be interesting to see how this evolves in practice.
- The audit market has fundamentally changed since the Competition Commission started its inquiry. The combination of the FRC's guidelines, the Competition Commission's investigation and the ongoing debate in Europe has led to a material and enduring increase both in scrutiny of auditors and in the frequency of audit tenders.
- While this does provide clarity in the UK audit services market, there will be some uncertainty until the position in Europe is finalised.

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