

Financial Reporting Council

Final report of Audit Choice Market Participants Group published

FRC PN 199

16 October 2007

The Financial Reporting Council today publishes the [final report of the Market Participants Group](#) that is advising the FRC on its Choice in the UK Audit Market project. The Group's 15 recommendations are set out below.

Background

An outcome of the first stage of the Choice in the UK Audit Market project was a strong preference amongst stakeholders for market-led solutions. The Market Participants Group was established in October 2006 to provide advice to the Financial Reporting Council on possible actions that market participants (i.e. companies, investors and audit firms) could take to mitigate the risks arising from the characteristics of the market for audit services to public interest entities in the United Kingdom.

The Group published its interim report and provisional recommendations for consultation in April 2007. Responses received from major investor and corporate representative bodies as well as individual audit firms and other market participants were considered by the Group in finalising its recommendations.

Findings

The Group noted that there is concern amongst market participants over the uncertainty and costs that could arise in the event of one or more of the Big Four firms leaving the market. This risk could be mitigated through increased choice of auditors. However a number of current market characteristics, when taken together, reduce the propensity of existing or new non-Big Four firms to make 'step change' investments in their capability to audit public interest entities and the propensity for public interest entities to select non-Big Four firms as auditors.

The Group evaluated a wide range of possible actions to increase choice of auditors. In its evaluation the Group sought to identify possible actions which would, when combined with others, contribute to increased choice whilst at least maintaining audit quality, at a cost which is proportionate to the likely benefits and at a cost which is lower than any alternatives offering equivalent benefits.

The responses to the Group's Interim Report demonstrated broad support for the interim recommendations. The Group has taken account of the responses in finalising its recommendations which are substantially unchanged from the provisional recommendations. The Group found no 'silver bullets' that could rapidly increase choice at a proportionate cost whilst maintaining audit quality.

Recommendations

The Group's 15 final recommendations are intended to:

- I Increase the feasibility of investment in the supply of audit services to public interest entities by existing non-Big Four firms or new firms
- I Reduce the perceived risks to directors of selecting a non-Big Four firm
- I Improve the accountability of boards for their auditor selection decisions
- I Improve choice from within the Big Four
- I Reduce the risk of firms leaving the market without good reason
- I Reduce uncertainty and disruption costs in the event of a firm leaving the market.

The recommendations set out actions that could be taken by market participants working collectively and enabling actions by regulators to allow the market to work more efficiently. The Group considers that the package of recommendations could have a positive impact on the degree of concentration in the supply of audit services to all but the very largest public interest entities over the medium term. In the longer-term this may provide a platform for non-Big Four firms who successfully respond to the opportunities created to expand into the audit market for the very largest public interest entities. The Group hopes that its recommendations will make a useful contribution to the wider international debate on audit market concentration.

Convenor of the MPG, and FRC Chief Executive, Paul Boyle said:

"Our consultation with stakeholders during 2006 revealed a preference for market-led, rather than regulatory, actions to address the risks arising from concentration in the audit market. The Group's recommendations have

the potential, over time, to reduce the barriers to market efficiency. The effectiveness of the Group's recommendations will be determined principally by the choices made by companies, investors and audit firms."

"The FRC is grateful to the members of the Market Participants Group who have worked constructively to develop these recommendations. We are also grateful to the individuals and organisations who submitted responses to the Group's provisional recommendations."

Appendix: List of recommendations

1. The FRC should promote wider understanding of the possible effects on audit choice of changes to audit firm ownership rules, subject to there being sufficient safeguards to protect auditor independence and audit quality.
2. Audit firms should disclose the financial results of their work on statutory audits and directly related services on a comparable basis.
3. In developing and implementing policy on auditor liability arrangements, regulators and legislators should seek to promote audit choice, subject to the overriding need to protect audit quality.
4. Regulatory organisations should encourage participation on standard setting bodies and committees by appropriate individuals from different sizes of audit firms.
5. The FRC should continue its efforts to promote understanding of audit quality and the firms and the FRC should promote greater transparency of the capabilities of individual firms.
6. The accounting profession should establish mechanisms to improve access by the incoming auditor to information relevant to the audit held by the outgoing auditor.
7. The FRC should provide independent guidance for audit committees and other market participants on considerations relevant to the use of firms from more than one audit network.
8. The FRC should amend the section of the Smith Guidance dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor selection decision.
9. When explaining auditor selection decisions, Boards should disclose any contractual obligations to appoint certain types of audit firms.
10. Investor groups, corporate representatives, auditors and the FRC should promote good practices for shareholder engagement on auditor appointments and re-appointments.
11. Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse impact on auditor choice when compared to the benefits to auditor objectivity and independence.
12. The FRC should review the Independence section of the Smith Guidance to ensure that it is consistent with the relevant ethical standards for auditors.
13. Regulators should develop protocols for a more consistent response to audit firm issues based on their seriousness.
14. Every firm that audits public interest entities should comply with the provisions of a Combined Code-style best practice corporate governance guide or give a considered explanation.
15. Major public interest entities should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.

Notes to Editors

1. The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance.
2. The FRC's functions are exercised principally by its operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Financial Reporting Review Panel, the Professional Oversight Board and the Accountancy & Actuarial Discipline Board) and by the Council. The Committee on Corporate Governance, whose members are drawn from the Council, assists it in its work on corporate governance.
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