



Governance *in brief*

Summary of final FTSE 350 audit tendering requirements

Headlines

- Mandatory tendering every ten years for FTSE 350 companies, FRC's comply or explain regime removed.
- Some FTSE 350 companies will have to re-think their planned audit tender dates.
- After five years of same auditor companies must explain in their audit committee report when they plan to tender the audit and why it is in shareholders' interest not to tender until that date.
- Audit committees must certify in their audit committee report that they have complied with the forthcoming Order.
- New rules to apply with effect from 1 October 2014.

Mandatory tendering every ten years

On 15 October the Competition Commission published its final decision on remedies closing the chapter on its inquiry into the statutory audit market for FTSE 350 companies. The Commission has now issued its final report which sets out further details on implementation, enforcement and transitional provisions. The full text is available at www.competition-commission.org.uk

The Competition Commission intends to issue an Order to the effect that FTSE 350 companies must put their statutory audit engagement out to tender not less frequently than every ten years.

The Commission will ask the FRC to amend the UK Corporate Governance Code to align with the Order.

Implementation and enforcement

The Competition Commission intends that the Order should prohibit auditors and FTSE 350 companies from entering into a statutory audit engagement agreement where the audit has not been put out to tender in accordance with the provisions of the Order.

The Commission is not mandating a particular form of tender process and welcomes the FRC's 'Audit Tenders: Notes on best practice', a summary of which is below and the full text of which is available from www.frc.org.uk

Transitional arrangements

The Commission's decision on transitional arrangements is as follows:

Last tender date	Tender requirement
Before 1 January 2005	Must go out to tender within two years of the end of the current Audit Engagement Partner's five year period.
Since 1 January 2005	May choose not to hold a tender process at the end of the current Audit Engagement Partner's five year rotation period, but must do so by the end of the final year of the following five year period.

The key difference between these arrangements and those currently in force under the FRC's current regime is that companies which last went out to tender between 2000 and 2005 may now need to plan to do their audit tender earlier. The Commission estimates that the number of FTSE 350 companies in this category to be less than 85. In accordance with the new requirements of the Competition Commission, these companies will need to go out to tender within two years of the end of the current Audit Engagement Partner's tenure.

Access to information

Companies have the right to require that the incumbent audit firm give them access to specified elements of the audit file for disclosure to rival bidders in a tender process. These elements include:

- information prepared for the Audit Committee on the planning, execution, and findings relating to the statutory audit of the group, parent and its principal subsidiaries;
- the principal audit risks and an accompanying commentary on whether these reflect risks within the business or in the control environment, or both;
- the incumbents' evaluation of the design, implementation and effectiveness of the control environment; and
- the breakdown of the current audit fee and the number of hours by staff grade and by audit task.

To the extent that any of the above information is not reproducible from documents provided to the Audit Committee, the company may require disclosure of this information from the incumbent firm's audit files.

New disclosure requirements

Where a company has not tendered in the last five years, the audit committee report shall state in which financial year it intends to go out to tender for statutory audit services and why the audit committee thinks that going out to tender in this year is in the best interests of shareholders.

In addition, companies must monitor and certify compliance with the provisions of the Order in the audit committee report.

Checklist of all current and proposed disclosure requirements in relation to audit matters

The UK Corporate Governance Code requires the following disclosures to be included in the audit committee report in relation to external audit **for periods commencing on or after 1 October 2012**:

The date of appointment of the external auditor, an indication of the date of the most recent audit engagement partner rotation and the date a tender was last conducted. Where the audit committee has agreed a tendering policy for the future, this should also be provided.	<input type="checkbox"/>
Any contractual obligations which acted to restrict the audit committee's choice of external auditors or a statement that there were no such obligations.	<input type="checkbox"/>
An explanation of how the audit committee has assessed the effectiveness of the external audit process. What approach has been taken to audit quality, timings, actions arising.	<input type="checkbox"/>
A clear indication of how the assessment of effectiveness described above has impacted the audit committee's approach to the appointment or reappointment of the external auditor plus the final decision on this.	<input type="checkbox"/>

In addition, from **1 October 2014**:

Where a company has not tendered in the last five years, the audit committee report shall state in which financial year it intends to go out to tender for statutory audit services and why the audit committee thinks that going out to tender in this year is in the best interests of shareholders.	<input type="checkbox"/>
A certification of compliance with the provisions of the Order in the audit committee report.	<input type="checkbox"/>

Timetable for implementation

We expect this Order to be published in Spring 2014 and to take effect from 1 October 2014.

FRC guidance on conducting an effective tender process

In response to requests from audit committee chairmen and others to provide some practical examples of how a tender might be conducted, the FRC has published suggestions to help companies undertake an effective process. Developed from a series of roundtables involving audit committee chairmen, investors, finance directors and auditors, the key steps identified to conduct an effective tender are:

- Be clear what you want to achieve and talk to major shareholders early on.
- Develop clear criteria that are right for the business - reputation of the firm alone is not sufficient. Seek investor views.
- Work with potential auditors to ensure they are free to compete under independence rules.
- Audit committee leadership is essential.
- Access to key personnel needs to be available and coordinated.
- Put audit quality, not price, at the top of your list.
- The role of the lead audit partner is key.
- Don't rule out incumbents without good reason.
- Allow sufficient time for an orderly handover. Plan the transition.

Applicability to non-FTSE 350 listed companies and AIM companies

These requirements apply only to the FTSE 350 premium listed companies. Other main market and AIM companies are not impacted by these requirements.

Deloitte view

- Almost one quarter of FTSE 350 companies will now have to re-think their audit tender dates as the flexibility under the FRC's regime will be removed on implementation of the Competition Commission's orders.
- The audit committee's role and accountability 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.
- The audit market has already 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 concluded.

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