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FRC disagrees with Competition Commission rotation plans

by Rachael Singh 20 Mar 2013

PLANS TO IMPOSE mandatory rotation of auditors advocated by the Competition Comission are flawed, according to the profession's watchdog.

In response to the commissions report into audit market concentration, the Financial Reporting Council (**FRC**) has disagreed with the commission's calls for of mandatory rotation and tendering.

According to the reporting watchdog, imposing such requirements could have an "adverse effect on audit quality, artificially constraining businesses' choice of audit firm".

In a **letter** to the commission, FRC chief executive Stephen Haddrill (pictured) said mandatory rotation would not guarantee new firms would emerge. In some sectors where there are only two or three audit firms which compete for work, such as insurance or banking, mandatory rotation could lead to a having no effective choice. Hadrrill argued that the FRC had been discussing the issue with mid-tier firms which were not contemplating investing to compete in this area of complex clients.

Haddrill also warned that mandatory rotation "would effectively undermine the authority of the audit committee operating in the best interests of investors by taking the question of reappointment out of their hands."

The FRC agreed that companies need to secure the best auditor for the business, but argued for the "comply or explain" method to audit tendering, which allows flexibility and recognises the role investors can play in governance issues.

According to Haddrill, a mandatory regime, which would remove the "comply or explain" element, could lead to retendering in an "inappropriate year, which would be contrary to investors' interests". Such as if a business were under-going major restructuring or engaged in take-over defence - when audit continuity would be critical.

"Concerns that comply and explain provides an ineffective stimulus are, we believe, misplaced," the letter said.

The **commission** has suggested it would look to strengthen accountability of the external auditor. The FRC recently extended reporting requirements for auditors and said in its letter the changes should be given time to take effect.

The FRC said it would welcome an opportunity to work with the commission to see whether its proposed changes would have an impact on the business community and how it would measure that.

Haddrill said: "Early signs suggest that provisions put in place by the FRC in the autumn revision of the UK Corporate Governance Code, regarding retendering on a ten year basis and increased reporting responsibilities of audit committees to investors are already making a difference.

"We are keen to discuss with the commission the case for further steps once there has been sufficient time for these changes to take full effect."

The FRC also raised concerns about the likely impact of a Big Four firm leaving the market and the short-term effect that would have on capital markets, as well as the long-term damage to confidence in corporate and financial reporting.

Other issues raised were concerns on an enlarged role for the audit committee which could exclude the finance director. This would be impractical, the FRC said, because the auditor would be unable to determine if there was an issue without speaking to the FD.