



July 13, 2012

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Mr. Chris Hodge
Director of Corporate Governance
Codes and Standards Division
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

RE: Proposed revisions to the UK Corporate Governance Code and
accompanying Guidance on Audit Committees

Dear Mr. Hodge:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA).

The CAQ appreciates the opportunity to respond to the Financial Reporting Council's (FRC) Consultation Document on Revisions to the UK Corporate Governance Code and accompanying Guidance on Audit Committees (April 2012). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The FRC is a preeminent thought leader on corporate governance and we strongly support its ongoing efforts to improve the performance of boards of directors and their audit committees, and to increase the transparency of their important work. The current UK Corporate Governance Code and accompanying Guidance on Audit Committees represent "best in class" governance principles for boards in overseeing the long term success of the company within a framework of prudent and effective risk management.

The FRC's insights and recommendations are respected by audiences around the world, whether or not they are subject to the FRC's formal jurisdiction.

The purpose of this letter is to share our perspectives on the broader implications of the FRC's proposed amendment of Section C3.6 of the UK Corporate Governance Code (Code) and similar additions to Section 4 of the Guidance on Audit Committees to require audit committees for FTSE 350 companies to put the external audit contract out to tender at least every ten years – or explain to shareholders why its actions are consistent with principles of good governance. Our perspective is shaped by a set of guiding principles that we have found useful in assessing new requirements in the United States relating to the oversight of auditors. These principles state that any new requirement should:

- improve or at least maintain audit quality;
- support and enhance the role of the audit committee in meeting its important responsibility to protect the interests of shareholders in relation to a company's financial reporting and internal controls;
- not impose a “one size fits all” approach to the multiplicity of company and board situations;
- meet its objectives in a manner such that the costs do not exceed the benefits; and
- take into consideration the implications for other major markets, given that consistency across jurisdictions is an important goal.

Applying these principles, we are concerned about the broader effects of a “comply or explain” retendering requirement. To date, academics and others, including regulators, have not seen a nexus between long audit tenure and audit quality. We know that, in the United States, retendering is a costly and often lengthy process that can serve to divert the attention of the audit committee, financial management and the auditors from their ongoing financial reporting and audit responsibilities. Moreover, the environment created by retendering requirements runs the risk of creating a “sales culture” at firms with unintended consequences such as pricing pressures. We note the FRC's recent warning to audit committees and auditors to guard against the impact that substantial fee reductions could have on audit quality in the name of audit efficiency. The FRC's June report on Audit Quality Inspections contained evidence that fee reductions may lead the auditor to reduce valuable audit work and compromise audit quality.

In the United Kingdom, the FRC provides well-established guidance for companies and shareholders regarding how to approach decisions not to comply with a regulatory provision. Compliance with regulations or corporate governance requirements in the United States, however, does not normally occur on a “comply or explain” basis. Compliance with all laws and regulations is the expectation and there is a strong and active culture of litigation with respect to such compliance. We anticipate that, in the United States, any determination not to comply with a provision likely would be interpreted as a breach. As a result, should a “comply or explain” requirement become the standard in the United States, there would be unremitting pressure for audit committees to retender and to hire a different auditor, effectively resulting in mandatory firm rotation, regardless of the merits. More importantly, as we and many others have expressed with regard to the PCAOB's concept release on the subject, a regime of mandatory rotation could actually undermine audit quality and interfere with

the role of the audit committee to oversee and select the auditor best suited for the company and its shareholders.

In recent testimony to the PCAOB, we observed support for a variety of policies and practices in order to build on the established governance and audit quality framework. We recognize that in order for the audit committee to oversee the audit and integrity of the company's financial reporting, there must be frequent, open and substantive communication between the audit committee and the external auditor, with the auditor bearing much of the responsibility for this communication.

A critical element of good corporate governance frameworks is the responsibility given audit committees to oversee the external auditor on behalf of investors. The CAQ believes that audit committees should be encouraged to take an even more proactive role in their oversight of the independent auditor. In this regard, one area for potential enhancement through best practices is the audit committee's annual assessment of the external audit firm, which is an important component of the audit committee's oversight of the financial reporting process and its determination of whether to retain the auditor. This is an area that may be improved through additional tools and training for audit committees as the protocols and processes for conducting the assessment can vary widely. Such an approach may have applicability in the UK context.

The FRC undoubtedly will hear from its constituents and take action it deems appropriate for the local market. If the FRC were to proceed with the "comply or explain" retendering policy notwithstanding concerns of the sort we have cited, it would be helpful for the FRC to acknowledge that its proposal is not predicated on any correlation between auditor tenure and audit quality, and to recognize that the UK approach may not be an appropriate approach for policy makers in other jurisdictions that have different legal, regulatory, and business environments.

The CAQ appreciates the opportunity to comment on the FRC's consultation papers. We would be happy to provide additional views on other ways to enhance audit quality and corporate governance based on work underway with the profession, audit committee community, investors and other stakeholders in the United States.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc: Stephen Haddrill, Chief Executive Officer
Paul George, Executive Director, Conduct