



**Audit and  
Assurance Faculty**

AuditQuality<sup>®</sup>

# Shareholder involvement – Auditor engagement: disclosure of contractual terms

How can boards and auditors provide greater transparency around the terms of the audit engagement and give shareholders greater insight into the audit approach and work? Consideration will be given to the content of audit engagement letters and publication of these letters on, for example, companies' websites.

The *Audit Quality Forum* brings together the audit profession, investors, business and regulators. Their purpose is to work together to generate policy proposals that will further enhance confidence in the independent audit by promoting transparency and accountability.

The Institute of Chartered Accountants in England and Wales, through the Audit and Assurance Faculty, convenes the *Audit Quality Forum*. The Institute initiated its *Audit Quality* programme in 2002 to drive thinking and practice in the field of audit and assurance. Alongside the Institute's *Information for Better Markets* campaign, the Forum is about working in the public interest to promote quality and confidence in corporate reporting.

The focus of the current agenda is to support shareholder involvement in the audit process. This is just the first stage. To quote from *Audit Quality*, 'Auditing is not a static discipline: committed professionals in any field strive for improvement and audit is no exception.'

There is more work to be done through the *Audit Quality Forum* to explore a broader agenda of issues relevant to the shareholder community.

Further information on the *Audit Quality Forum*, the current work programme and how to get involved is available at [www.icaew.co.uk/auditquality](http://www.icaew.co.uk/auditquality) or contact 020 7920 8493.

Anyone interested in providing feedback on this policy proposal may send comments to [tony.bromell@icaew.co.uk](mailto:tony.bromell@icaew.co.uk).

The Audit and Assurance Faculty's publication, *Audit Quality*, identified client relationships, including the effective management of client portfolios and working with individual clients, as one of the key drivers of audit quality. Whilst auditors deal with the directors and management of the company on a day-to-day basis when carrying out their audit, their ultimate responsibility is to the shareholders. The client relationship needs to be managed effectively so that auditors can perform their audit and provide an independent opinion to the shareholders on the truth and fairness of the financial statements which have been prepared by the board.

The statutory audit is a means of addressing issues that arise from the agency relationship that exists between the shareholders and the board of directors. There are, however, perceived transparency issues for shareholders around the effectiveness of audit as a solution to agency problems, including the nature of shareholder involvement and the availability of choice in the audit market.

The *Audit Quality Forum*, launched in December 2004, identified four initial measures that may improve audit transparency and bring real benefits to shareholders as well as the longer-term issue of competition and choice. The Institute established working parties with representation from key stakeholders to take the matters forward and identify technical and practical issues for discussion at the *Audit Quality Forum* on 7 March 2005 and to report on how these matters may be taken forward to implementation.

This policy proposal considers how the transparency of contractual terms in audit engagement letters may be improved.

AuditQuality<sup>®</sup>

Shareholder involvement –  
Auditor engagement:  
disclosure of contractual terms

## Preface

In the light of shareholder concerns, this report sets out a policy proposal to improve transparency by disclosing the contractual terms in audit engagement letters.

This proposal is part of a series of reports produced to enhance the statutory audit. The report was produced by a working party, details of which are included in Appendix 3. The proposal was considered by participants at the *Audit Quality Forum* on 7 March 2005. Broad consensus was reached on this proposal with the following matters being identified for further consideration:

- > Shareholders would like to see the terms of engagements before approving audit appointments. Therefore should the engagement letter be required to be published before the AGM? It was noted that this might present practical difficulties although the point merited further consideration.
- > If it is pertinent for non-audit fees to be disclosed to shareholders, should all relationships with auditors be subject to similar disclosure? It was noted that the working party's focus had been on audit engagement letters. Publication of all engagement letters may be confusing although disclosure may be optional.
- > As an alternative to disclosing the letter, could the audit committee report disclose the key terms, just as key elements of directors' contracts are disclosed rather than the whole contract being made available? This suggestion was noted.
- > Some investors thought it might be useful to see some sample letters on an anonymous basis before pressing ahead with the proposal.

The report has not been amended in respect of the above matters. The working party considered the principal issues related to timing and scope of disclosure and does not believe it would be appropriate to require the engagement letter for the subsequent year to be approved by or at the AGM for the preceding year. The audit process for the previous year finishes at the AGM, and there are many factors for the audit committee and the auditors to take into consideration before agreeing the following year's detailed terms. There would be a high likelihood of changes to any letter so agreed. There is also a risk that consideration of the engagement letter at the AGM could distract attention from more important governance issues.

In relation to disclosure of non-audit engagement letters, the working party does not believe that publication of detailed contractual terms should be required since this could give rise to prejudicial and for potentially onerous disclosures.

The working party also noted that shareholders could ask questions regarding prior year engagement letters and non-audit fees should they wish. The audit committee's role in relation to these issues could be addressed as part of the project on audit committees that the *Audit Quality Forum* is considering undertaking. The report is being published so that the appropriate government and regulatory bodies can take such action as they consider appropriate in accordance with their own due process.

## Contents

	Page
<b>Preface</b>	2
<b>Executive summary</b>	4
<b>Contractual terms in audit engagement letters: the issue</b>	5
<b>Background</b>	6
Corporate governance requirements	6
Audit engagement letter requirements	6
Typical contents of an engagement letter	6
<b>The recommendations</b>	7
Specific measures	7
<b>Benefits and impact</b>	8
<b>Detailed considerations</b>	9
Scope: companies to which the recommendation should apply	9
Scope: types of engagement to which the recommendation should apply	9
Legal and confidentiality issues	9
Means of disclosure	10
Means of implementation of recommendation	10
Timing of requirement to disclose	11
Audit planning information	11
<b>Next steps</b>	12
<b>Appendix 1: Extracts from Auditing Standard ISA (UK &amp; I) 210 <i>Terms of audit engagements</i></b>	13
<b>Appendix 2: Draft insertion for Combined Code</b>	15
<b>Appendix 3: Working party</b>	17

## Executive summary

The *Audit Quality Forum* provides stakeholders with an opportunity to discuss issues around audit transparency and accountability. As a consequence of the Forum meeting in December 2004, a number of issues around shareholder involvement were raised and working parties were set up to consider these various aspects with the objective of making recommendations to address these concerns.

The working party that has produced this policy proposal was established to consider the practical, technical and legal issues around making audit engagement letters publicly available through, for example, publication on company websites, as well as considering the appropriate content of such letters. In reaching their conclusions the working party considered the current requirements relating to audit engagement letters, the typical contents thereof, potential legal and practical issues and perceived concerns by shareholders around audit engagement letters.

The recommendations of the working party are:

- > audit firms and directors should be encouraged to agree that the engagement letter relating to the opinion given in respect of the UK statutory audit should be publicly disclosed for all quoted companies;
- > guidance should be given on matters which might generally be addressed in the engagement letter for the audit of a typical quoted company. This would be regarded as good practice but not an absolute requirement;
- > the proposed matters to address should include, inter alia, identification of the name of the partner who will sign the audit report and clarification of any restriction in the auditors' duty of care;
- > audit firms should be encouraged to review the wording of the letters with a view to making them as useful as possible for publication;
- > disclosure should be by way of inclusion on the quoted company's website within 21 days of the audit engagement letter being approved by the Board. Any changes subsequently agreed should also be disclosed within the same time frame. If the quoted company does not have a website, the audit committee's report in the annual report and financial statements should note where the audit engagement letter might be obtained from; and
- > the disclosure of the audit engagement letter should be included in the Combined Code, with the recommended matters to be addressed in the 'Smith Guidance'.

These recommendations are made to give shareholders greater insight into the audit approach and to provide an additional mechanism in shareholders' assessment of the directors' stewardship of the company.

## Contractual terms in audit engagement letters: the issue

Under UK law, the audit report that ensues from the audit process is addressed to the shareholders of the company audited. The audit engagement letter forms the contract under which the audit is performed. The contract might be expected therefore to be agreed by the auditors as the provider of the service and the shareholders as a body, as the recipients. In practice this is not practicable, especially for quoted companies with a wide range of shareholders. The audit committee (for listed entities, as expected by the Combined Code on Corporate Governance) or the board of the company therefore approves the engagement terms before the contract is agreed to and signed on behalf of the company by the directors. In this way the contract with the auditors is made by the directors for the shareholders who, for these purposes, are the company.

Perceived concerns from shareholders are that this process is opaque, that although the directors sign the contract as agent for the company/shareholders, shareholders do not know what contractual terms have been agreed on their behalf and that shareholders have no means of assessing the directors' stewardship of the company in this respect. In view of the importance of the audit in addressing the agency relationship between directors and shareholders,<sup>1</sup> the contractual terms of engagement should be made available to shareholders.

The working party was tasked by the *Audit Quality Forum* with considering:

'Making audit engagement letters publicly available through, for example, publication on company websites; as well as considering the appropriate content of such letters.'<sup>2</sup>

The working party has therefore looked at how disclosure will give value to shareholders, subject to legal and practical considerations, with a view to making a recommendation as to what disclosure might be made, when and how, to address the concerns of shareholders.

The working party has specifically concentrated on the following areas:

- > the current requirements and typical content of audit engagement letters;
- > legal and practical constraints relating to disclosure;
- > shareholder attitudes and aspirations relating to the audit contract and how it is agreed; and
- > whether for companies the benefits of disclosure are likely to exceed the costs.

When considering these issues and reaching a consensus on its recommendations, the working party has been mindful of the need to consider the impact of any proposals on all the stakeholder parties and to ensure a fair balance for those concerned.

---

<sup>1</sup> See 'Supporting shareholder involvement'.

<sup>2</sup> ICAEW letter to DTI, 9 December 2004.

# Background

## Corporate governance requirements

Code Provision 3.2 of the Combined Code on Corporate Governance ('Combined Code': applicable to entities listed on the London Stock Exchange on a 'comply or explain' basis) expects the audit committee to approve the terms of engagement of the external auditor. Annexed to the Combined Code are a number of items of guidance which suggest ways of applying the relevant Combined Code principles and complying with the relevant Combined Code provisions. One of these is *Guidance on audit committees* also known as 'The Smith Guidance'. This states in particular:

'The audit committee should review and agree the engagement letter issued by the external auditor at the start of each audit, ensuring that it has been updated to reflect changes in circumstances arising since the previous year. The scope of the external audit should be reviewed by the audit committee with the auditor...'<sup>3</sup>

## Audit engagement letter requirements

The law is silent on requirements relating to audit engagement letters, provided they meet the general requirements relating to contracts. However, Auditing Standard ISA (UK & I) 210 *Terms of audit engagements*, covers the issue and must be adhered to when conducting a true and fair view audit of financial statements in the UK and Ireland. The Standard was issued in December 2004, though the substance of the requirements is similar to those previously in place. It recommends but does not require an audit engagement letter. It does however require the terms of an audit engagement to be agreed and to be recorded in writing. It also considers the likely contents of an audit engagement letter. The relevant paragraphs are reproduced in Appendix 1 but, typically, other matters are also covered which are considered below.

## Typical contents of an engagement letter

The working party reviewed an analysis of letter of engagement templates in issue by a number of the larger and medium-sized audit firms. These vary slightly in terms of style and detail but the substance of the items covered is similar.

---

<sup>3</sup> *Guidance on audit committees* July 2003, paragraph 4.19.



## The recommendations

Having considered the current requirements relating to audit engagement letters, the typical contents thereof, potential legal and practical issues and perceived concerns by shareholders around audit engagement letters, the recommendations of the working party have centred around the need to ensure that:

- > useful information is being communicated to shareholders about the contractual terms of the audit engagement; and
- > the scope of companies covered, method and timing of disclosure and expected minimum contents are such that the disclosure is cost beneficial.

To this end, the working party makes the following recommendations:

### Specific measures

1. Audit firms and directors should be encouraged to agree that the engagement letter relating to the report given in respect of the UK statutory audit, should be publicly disclosed for all quoted companies.<sup>4</sup>
2. Guidance should be given on matters which would generally be included in the engagement letter for the audit of a typical quoted company. This would be regarded as good practice but not an absolute requirement. A proposed list is included in Appendix 2. This includes, inter alia, identification of the name of the partner who will sign the audit report and clarification of any restriction in the auditors' duty of care (for example, that it is only to the shareholders as a body, and that by agreeing to publication, the auditors are not extending or adding to their responsibilities).
3. It is accepted that audit engagement letters form a legal contract and, having regard to some of the complexities arising from audit regulation, legal wording is therefore inevitable. However, audit firms should be encouraged to review the wording of the letters with a view to making them as useful as possible for publication. A number of legal considerations are noted in the 'Detailed considerations' section below.
4. Disclosure should be by way of inclusion on the quoted company's website within 21 days of the audit engagement letter being approved by the Board. Any changes subsequently agreed should also be disclosed within the same time frame. The audit committee's report in the annual report and financial statements should note where the audit engagement letter might be obtained from. If the quoted company does not have a website, it would be acceptable to specify in the audit committee report another website where it can be obtained from.
5. The disclosure of the audit engagement letter should be included in the Combined Code with the recommendation of matters to address in the letter included by way of amendment to the Smith Guidance annexed thereto. Accordingly, for companies not listed on the main London market, disclosure would only be best practice.

The benefits and impact of the specific measures are set out over.

---

<sup>4</sup> A quoted company is defined in the 1985 Companies Act, section 262(1), as a company whose equity share capital has been included in the official list in accordance with the provisions of part 6 of the Financial Services & Markets Act 2000, is officially listed in an European Economic Area state or is admitted to dealing on either the New York Stock Exchange or the exchange known as NASDAQ. This is a broader definition than that applied to the OFR regulations.

## Benefits and impact

Two key shareholder requirements are to know more about their company and to be able to assess the directors' stewardship of it. The new Operating and Financial Review requirements, implemented in the proper spirit, will assist with this, as might the outcome of the work of the working party on *Questions to the auditor*. However, in view of the importance of the audit in addressing the agency issue<sup>5</sup> and of the audit committee in handling the audit process, shareholders need to have information to be able to assess the audit committee's role (as well as that of the Board) in the stewardship requirements. While it is wholly appropriate that the audit committee should handle the terms of the engagement contract with the auditors, disclosure of those terms should be a helpful mechanism in shareholders' assessment of the effectiveness of the Board.

An assessment of the terms of the engagement, even though they do not contain detailed planning information, would also give shareholders greater insight into the audit approach and work.

The contents of the audit engagement letter form a legal contract for the supply of a complex service and engagement letters in practice are long, in quasi legal language and much of the text is focused on making sure the respective responsibilities of auditors and directors are understood by the directors. There are also a number of regulatory requirements that need to be addressed in the letter. Inevitably, therefore, scope for amending the contents of the letter is limited. However, it is the belief of the working party that if audit engagement letters are published, auditors will have an incentive to make them as simple and free of jargon and legal terminology as possible. This will not only benefit shareholders' understanding of the audit engagement terms, but that of directors as well.

---

<sup>5</sup> See 'Supporting shareholder involvement' above.

## Detailed considerations

### Scope: companies to which the recommendation should apply

Unquoted companies have a narrower range of stakeholders than quoted companies and wider transparency would, in the view of the working party, have limited, if any, benefit. Bearing in mind also that any requirements for such companies would need to be brought in by law to be effective, the working party believes that the benefit of the measure would be unlikely to outweigh the cost of disclosure. It is therefore recommended that the scope should be limited to 'quoted companies'.

### Scope: types of engagement to which the recommendation should apply

The UK statutory audit is undertaken, under UK law, for the shareholders and it is therefore not unreasonable for the terms of the audit engagement to be made widely available in an entity whose shares are available to the public. Other services are a matter between the company (in the form of its Board) and the supplier and there is less rationale for engagement letters in respect of such services to be disclosed. The working party is of the view, therefore that the requirement for disclosure should relate only to the engagement letter relating to services surrounding the opinion given in respect of the UK statutory audit. This would also ensure that there is no potential conflict with confidentiality or other issues relating to audit work performed in respect of requirements in other jurisdictions.

There should, however, be no reason in principle why other matters cannot be included in the engagement letter published, if so wished.

### Legal and confidentiality issues

The working party is aware of a number of potential issues arising in respect of disclosure of audit engagement letters but believes that they do not impose an insurmountable hurdle. These issues include:

- > If engagement team members are named in the audit engagement letter, there could be a Data Protection Act disclosure issue. The rights of engagement team members under the Data Protection Act not to have their personal data processed (which includes disclosure of their names) unlawfully or unfairly will be breached by the publication of an engagement letter with their names in it. In addition, posting on a website will contravene the requirement that personal data should not be transferred outside of the European Economic Area unless the relevant territory has 'an adequate level of protection' for personal data. Relevant provisions of the Act are Principles 1 to 8, which have to be followed by holders of personal data. Under the Act, consent is a justification for processing (Schedule 2) or transferring overseas (Schedule 4). Audit firms would therefore need to obtain consent to publication from any members of the audit team who are identified in (or are identifiable from) the engagement letter. It is not clear that the objectives of publishing would be met or enhanced by disclosing who the audit managers are. It is also possible that audit team members may not want their names disclosed publicly.

- > There may also be personal protection issues arising from engagement team members being named in the letter, with specific names being related to audits of, for example, companies subject to the attentions of animal rights extremists. An exemption in respect of disclosure of names for such companies would be required. The working party does not believe that disclosing the names of all engagement team members should be necessary or of particular benefit to shareholders, though it is recommended that the audit engagement partner should be identified. The working party on *Identifying the audit partner* is recommending that the name of the partner responsible for signing the audit report be indicated in that report: on that basis, earlier identification in the audit engagement letter would be of potential use to shareholders.
- > Contracts will generally be confidential as between the auditor and the company. In practice the company is the corporate form of the body of shareholders. There can be no confidentiality issue therefore relating to disclosure of the audit engagement letter to shareholders but posting on a website means that the world at large can view it. The audit firm can waive its confidentiality (or consent to publication of the letter) and the shareholders can be taken to have waived confidentiality/consented to publication through the directors (the directors agreeing to the waiver on behalf of the shareholders). The working party believes that each waiver or consent should be included in the audit engagement letter, to simplify matters and for clarity.
- > There may be issues relating to overseas regulation of, for example, dual-listed entities, were matters related to the audit work necessary in that jurisdiction to be included in the audit engagement letter. As noted above, the working party does not believe that engagement terms in respect of audit work outside of the UK should necessarily be included in a letter intended for publication.

### Means of disclosure

One disclosure option considered was to propose that audit engagement letters be made available at Annual General Meetings. However, there was some concern that for the disclosure to be useful, making the letter available only on request to those turning up at the AGM, necessarily once a year only, would be unhelpful. As the measure is intended to be restricted to quoted companies, it is likely that most would already have a website and it would therefore probably be less costly to use that medium rather than the AGM (copying arrangements would need to be made at the latter, for example).

The working party has proposed that the audit committee report should note where the audit engagement letter might be obtained. Therefore if the company does not have its own website, it would not be difficult to specify in the audit committee report a website where the letter can be inspected.

The working party is also of the view that a more widespread availability would increase the encouragement to audit firms to make the letters more readable.

### Means of implementation of recommendation

The *Audit Quality Forum* held in December 2004 indicated a number of common areas of clear agreement by all stakeholders. These included a preference for conducting affairs within a framework of principles over rules and a 'best practice/comply or explain regime', rather than statute. The latter is inevitably cumbersome, inflexible and slow to react to change. Given this preference and the scope of companies to be covered by the recommendation, the working party believes that the underlying disclosure

recommendation should ideally be embedded in corporate governance requirements in the Combined Code itself. In addition, the recommendation as to good practice in terms of what matters might be covered, which is not intended to be mandatory, should be included as an amendment to the Smith Guidance.

### Timing of requirement to disclose

It is important for information to be sufficiently up to date to be of use to shareholders but recommended best practice should not make unreasonable impositions, given practical considerations. For example, the audit committee needs to approve terms of engagement but only meets every so often. For the audit committee to do its job properly, it would therefore be unlikely that the signed audit engagement letter for the following year could be available by the AGM. The working party has therefore recommended that the audit engagement letter should be published within 21 days of its being signed by the Board. Generally, approval would be expected to take place much earlier in the audit process. There may be a rare occurrence where the audit engagement letter for the year just ended would be finally approved and therefore published just before the audit report is signed. There may be occasions when the contractual terms need to be changed during the course of the audit. In such cases, any changes subsequently agreed should also be disclosed within the same time frame.

### Audit planning information

The working party is aware that there have been expectations in some quarters that the audit engagement letter should include details relating to the audit plan (risk assessments, planned audit procedures, areas to be concentrated on, etc.). Such matters are not included in current audit engagement letters because they do not form part of the contractual terms. The audit plan is primarily a document prepared for use by the auditors, to facilitate the efficient performance of their audit functions. It is for the auditors to determine how they discharge their audit duties. ISA (UK and Ireland) 300 *Planning an audit of financial statements*, states this quite clearly and does not contemplate audit planning matters being dealt with within the engagement letter.

The working party does not believe that it would be appropriate to include such information in the audit engagement letter and that the audit committee should deal with it from the shareholder perspective. Pertinent information can be disseminated through, for example, the OFR in due course. In addition, the working party on *Questions to the auditor* proposes permitting auditors to be asked questions under certain circumstances. This allows a route for audit related matters which should properly be in the public domain, to be raised with auditors.

## Next steps

The working party recommends that the FRC take forward proposals to require audit engagement letter disclosure by amendment to the Combined Code directly and to the *Guidance on audit committees* annexed thereto.

# Appendix 1

## Extracts from Auditing Standard ISA (UK & I) 210

### *Terms of audit engagements*

'5-1 In the UK and Ireland, the auditor should ensure that the engagement letter documents and confirms the auditor's acceptance of the appointment, and includes a summary of the responsibilities of those charged with governance and of the auditor, the scope of the engagement and the form of any reports.

- 6 The form and content of audit engagement letters may vary for each client, but they would generally include reference to:
- The objective of the audit of financial statements.
  - Management's responsibility for the financial statements.<sup>6</sup>
  - The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres.
  - The form of any reports or other communication of results of the engagement.
  - The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.
  - Unrestricted access to whatever records, documentation and other information requested in connection with the audit.
- 7 The auditor may also wish to include in the letter:
- Arrangements regarding the planning and performance of the audit.
  - Expectation of receiving from management written confirmation concerning representations made in connection with the audit.
  - Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.<sup>7</sup>
  - Description of any other letters or reports the auditor expects to issue to the client.
  - Any confidentiality of other letters or reports to be issued and, where appropriate, the conditions, if any, on which permission might be given to those charged with governance to make those reports available to others.
  - Basis on which fees are computed and any billing arrangements.
  - Procedures where the client has a complaint about the service provided by the auditor.<sup>8</sup>

<sup>6</sup> In the UK and Ireland, those charged with governance are responsible for the preparation of the financial statements.

<sup>7</sup> Acceptance by the client of the terms of the engagement is normally evidenced by signature by a person at an appropriate level within the entity, for example the finance director or equivalent.

<sup>8</sup> Certain professional bodies require members to notify clients of their own complaints procedure and of the client's right to make complaints to those professional bodies. This might appropriately be included in the engagement letter.

- 8 When relevant, the following points could also be made:
- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
  - Arrangements concerning the involvement of internal auditors and other client staff.
  - Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
  - Any restrictions of the auditor's liability when such possibility exists.
  - A reference to any further agreements between the auditor and the client.

An example of an audit engagement letter is set out in the Appendix.<sup>9</sup>

- 9 When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors and influence the decision whether to send a separate engagement letter to the component include:
- Who appoints the auditor of the component.
  - Whether the terms for each component are the same.
  - Whether a separate audit report is to be issued on the component.
  - Legal requirements.
  - Regulatory requirements.
  - The extent of any work performed by other auditors.
  - Degree of ownership by parent.
  - Degree of independence of the component's management.
- 9-1 If the auditor sends one letter relating to the group as a whole, it identifies the components for which the auditor is appointed as auditor. Those charged with governance of the parent entity are requested to forward the letter to those charged with governance of the components concerned. Each board is requested to confirm that the terms of the engagement letter are accepted.'



## Appendix 2

### Draft insertion for Combined Code

The board shall endeavour to ensure that the agreed contractual terms of the engagement to provide services surrounding the opinion given in respect of the UK statutory audit, should be publicly disclosed on the company's website, within 21 days of those terms being agreed by the board. Such terms are usually included in an audit engagement letter. Any changes to the contractual terms subsequently agreed should also be disclosed within the same time frame.

The report of the audit committee in the annual report and financial statements should note the website address where the audit engagement letter might be obtained. If the company does not have a website, the audit committee's report shall specify another website where it can be obtained.

The *Guidance on audit committees* annexed hereto includes matters which might, inter alia, generally be addressed in the audit engagement letter.

### Draft insertion for *Guidance on audit committees*: Matters which might generally be addressed in audit engagement letters disclosed

1. Confirmation of the appointment, including acknowledgement and acceptance.
2. The relative responsibilities and obligations of the directors and the auditor:
  - under the Companies Act and Listing Rules (or equivalent);
  - for detection and prevention of irregularities and fraud;
  - in respect of other information that is to be issued with the financial statements prior to publication;
  - in respect of post balance sheet events;
  - for web posting of the letter and for maintenance of the relevant website.
3. The professional responsibilities of the auditor, including where appropriate, acknowledgement of responsibility for the group audit opinion
4. The scope of the audit: which companies'/groups' financial statements are covered.
5. Procedures in respect of management representations.
6. Arrangements for reporting to the audit committee or others charged with governance.
7. Confirmation of ownership of audit working papers.
8. Where applicable, arrangements setting out responsibilities and the basis of any work relating to:
  - summary financial statements;
  - additional work relating to corporate governance statements;
  - preliminary announcements;
  - electronic or similar publication of audit reports.

---

<sup>9</sup> Not reproduced here.

9. Liability arrangements and limitations, if any; responsibilities relating to reporting to third parties, limitations re claims against employees; confirmation regarding to whom the auditors will report and to whom they will accept responsibilities; clarification that by consenting to publication the auditors are not extending or adding to their responsibilities.
10. The complaints procedure should the company be dissatisfied with the service provided.
11. Agreement by both parties to waive confidentiality or to consent to publication of the contractual terms.
12. Confirmation that the definitive version of the engagement letter will be that manually signed and that the audit firm will provide an electronic version for publication on the company's website
13. The basis on which fees will be computed, rendered and paid.
14. Independence requirements re rotation of partners
15. Obligations under the Data Protection Act.
16. Clarification of which jurisdiction's law governs the terms of the above contract.

## Appendix 3

### Working party

We are grateful to the following people for their input to this policy proposal issued to the *Audit Quality Forum*. Their input does not necessarily reflect the views of the organisations they work for or are attached to.

Martyn Jones – Chair  
*Deloitte*

Christopher Arnull  
*KPMG*

Tony Bromell  
*ICAEW*

Julie Ford  
*Department of Trade and Industry*

Don Hutchison  
*BDO*

Ken Lever  
*Tomkins PLC*

Michael McKersie  
*Association of British Insurers*

Peter Rowley  
*Grant Thornton*

Andrew Tusa  
*Deutsche Asset Management*

John Wroe  
*BT Group Plc*