



20 March 2007

By post and e-mail to: jgrant@frc-apb.org.uk

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Financial Reporting Council
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Dear Mr Grant

FRC Discussion Paper: Promoting Audit Quality

3i Group welcomes the opportunity to respond to the above Discussion Paper.

In responding to this paper, we:

- comment on the specific questions for consultation where relevant to the experience of 3i (see Appendix I);
- provide background information on 3i Group plc ("3i") (see Appendix II).

If you have any questions on this response please do not hesitate to contact Gordon Craig, Director, Group Risk Assurance & Audit on Tel. No. 020 7975 3372 or at e-mail gordon.craig@3i.com.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Ball', written over a horizontal line.

Simon Ball
Group Finance Director

c.c. Gordon Craig

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Appendix I

Summary of recommendations and comments

As noted on page 5 of the discussion paper, there have been a number of changes to the financial reporting regime in recent years, which have not yet been fully assimilated and the full impact of which is not yet known. As acknowledged in Appendix 1 of the paper, the recent consultations on extending public reporting of AIU inspection findings and on the publication of 'transparency reports' by auditors, regarding their quality control and governance processes, have a direct bearing on the issue of audit quality. The project on competition and choice in the audit market may also be of some relevance.

In this context, the timing of this discussion may limit its value. Nevertheless, the paper addresses an important and potentially complex topic in a structured way, raising questions which will need to be re-visited as part of any fundamental review which may take place in the future.

There is also a need to underpin and inform any future review with appropriate supporting evidence or research, which is lacking in the current discussion paper. For example, the AIU could publish more data from its inspection reports, in a suitable form, specifically for such a purpose.

Question 1

Are there other important indicators of an audit firm's culture that are not referred to above?

The paper identifies a number of useful potential indicators of whether an audit firm has an appropriate culture from the perspective of enhancing audit quality. An assessment of the relative importance and completeness of the indicators identified would benefit from some relevant empirical research data.

Question 2

Are there pressures that could compromise the culture of audit firms that have not been identified above?

The paper focuses on the threats deriving from economic pressures. Other threats may exist, however, which may not be directly linked to economic considerations. Possible examples include weak leadership; poor execution of training; inadequate communication; poor staff morale; and lack of clear responsibility and accountability.

Question 3

Are there any further steps that should be taken to build confidence in the culture of audit firms and, if so, what might they be and why are they needed?

The paper identifies an important issue around the matter of providing evidence and information to users that firms do promote a culture which is likely to support audit quality.

The recent consultations on extending public reporting of AIU inspection findings and on the publication of 'transparency reports' by auditors regarding their quality control and governance processes have a direct bearing on the issue of confidence. We would recommend that any decisions on further steps should await the outcome of that work and implementation of any associated recommendations.

Question 4

Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?

We would agree that all of these factors are key drivers of audit quality. However, the assessment of key drivers would benefit from some relevant empirical research data.

Question 5

Has this paper identified the issues that could result in an inadequately trained or skilled workforce for audit – if not, what other issues are there and why are they issues?

A number of the factors mentioned in section 3.5, in relation to economic pressures, are also relevant here. These would include levels of investment in appropriate training and overall resourcing levels.

Question 6

Should there be a fundamental review of the qualifications and training requirements for auditors?

We do not see any compelling evidence or arguments that a fundamental review is needed at this time.

Question 7

Are there other factors that determine whether an audit process is effective?

An effective audit process involves a combined effort between the external auditors, the audit committee, management and, where relevant, internal audit. These important matters are covered later in Chapter 7, but should also be referred to in the context of this specific point.

Question 8

Are there threats to the effectiveness of the audit process that have not been identified above?

An important threat, not mentioned, is the ability to apply and adapt the audit process to a changing business environment. Section 1.12, refers to some relevant issues, including accelerated reporting and increasing complexity of transactions. These require a combination of experience, sound judgement and knowledge of the business of the client on the part of auditors.

The effectiveness of the audit process could also be impaired significantly if, for example, management and/or the audit committee do not fully support auditors in the effective discharge of their responsibilities. This matter is addressed later in Chapter 7 of the discussion paper.

The threat of increased use of computerised audit methodologies may be misplaced. As noted, the comments are based on 'anecdotal evidence', and do not fully recognise many of the positive benefits of technology, including better documentation of audit work, planning efficiencies and more effective information sharing. The real threat is the lack of proper interaction with the client, which may have more to do with the skills and personal qualities of the audit partners and staff, referred to in Chapter 4, as well as the support of management.

Question 9

Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?

The discussion paper identifies two points. The first is the risk of auditing standards becoming over-prescriptive, the negative implications of which are summarised in section 5.21 of the paper. The second relates to the current requirements regarding lead audit partner rotation, appointment of an ethics partner and having an 'independent partner' review process. As noted in the discussion paper, the application of these standards needs to be monitored and assessed before considering the need for further change.

Question 10

Are there other factors that determine whether audit opinions command confidence?

The role of confidence in the presumed quality of the audit process, referred to in paragraph 6.4, should be given more prominence as a factor in its own right. Related to this is the credibility of the monitoring of auditor competence and independence through, for example, the work of the AIU.

Question 11

Are there other reasons why users may not have confidence in the audit opinion?

The analysis in this chapter has a narrow focus on the form and content of the audit report. There is no reference to wider issues such as the role of auditor reputation or 'brand', as a component of perceived audit quality which could have an impact on user confidence in the audit opinion.

Question 12

Are there further steps that could be taken to reinforce confidence in an audit opinion? In particular, what changes to the form and content of the audit report should be considered?

There are clearly a number of changes in progress already which will or may impact confidence in audit opinions. In this context, we have not identified any further steps which need to be

taken nor would we support changes to the form and content of the audit report at this stage.

Question 13

Are there other external factors that have the potential to adversely affect audit quality?

Changes in the business environment detailed in section 1.12, such as increasing complexity, are also relevant.

Question 14

Are audit committees discharging their responsibilities in relation to audit adequately, and if not, what further steps might be taken to make their role more effective?

We are not in a position to assess directly how other committees discharge their responsibilities in relation to audit. Based on our own experience, current guidance in the Combined Code is adequate and should be effective when properly applied.

We would also draw attention to the work of the POB on transparency reporting and around reporting by the AIU, the outcome of which may result in more information being made available to audit committees which could assist them in their role.

Question 15

Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?

The Combined Code already contains guidance for audit committees on their role, including the evaluation of the effectiveness of the audit process. In our view, more detailed guidance at this stage is unnecessary.

Question 16

Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?

The Combined Code already requires a description of the work carried out by the audit committee in discharging its responsibilities in the annual report. This work includes reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process. In our view, further prescription in this area is unnecessary.

Question 17

Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?

We have not identified the need for further steps to be taken at this stage.

Appendix II

About 3i

3i is an investment trust and a constituent of the FTSE 100 Index with a market capitalisation of approximately £4.1 billion. 3i is a world leader in private equity and venture capital with over 750 employees operating in Europe, Asia Pacific and the USA with a portfolio of approximately 1000 unquoted investments.