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Private and Confidential

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Our ref: 72/DHU/JEC Grant (FRC)

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Dear Mr Grant

Promoting Audit Quality

We thank you for the opportunity to comment on the discussion paper "Promoting Audit Quality", issued in November 2006.

Our overall view is that it is a well timed and considered discussion paper in the light of the continuing need to ensure confidence in the value and quality of audit opinions. What is less clear is how the feedback you get will be used; however, from this firm's perspective we would wish any approach derived from this to be measured, and not to result in the further creation of more prescriptive standards; there needs to be some time given to bedding down the large number of new auditing and financial reporting standards implemented over the last 3 years.

Whilst acknowledging there can be no room for complacency this is against a background of a genuine belief that as, regards auditing and corporate governance, the UK has over the last 15 years or so, ensured that it is in the forefront of best practice.

One issue which, as you are aware, we have promulgated as a firm, and which is touched on but not expressly put forward as a suggestion in your discussion paper is the role of the AIU in being uniquely positioned as the independent reviewer of those auditing firms' engaged in public interest entity audits; it would seem to us a logical next step to allow the AIU to report publicly on those firms' attitude and adherence to at least 3 of the 4 main drivers of quality identified:

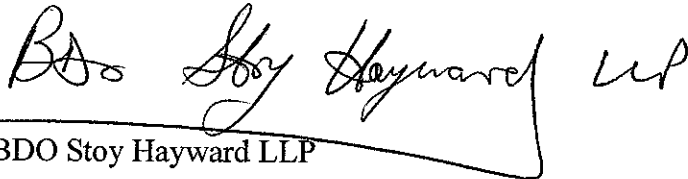
1. Audit firm culture;
2. Qualities of audit partners and staff; and
3. Quality of audit process.

This would be seen to be an additional level of assurance and a further aid to transparency beyond that simply provided by the firms themselves through self-reporting.

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We respond to the individual questions asked in the discussion paper in the attached schedule. Should you wish to discuss any of our comments, please feel free to contact, Don Hutchison on 020 7893 2625 or via email don.hutchison@bdo.co.uk.

Yours sincerely



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The culture within an audit firm

We would support your analysis of the culture within an audit firm and with the need for more transparency on internal governance and quality control processes. As noted in our summary letter we believe there is an opportunity for the AIU to have a broader public reporting role here.

- Q.1 Are there important indicators of an audit firm's culture that are not referred to above?

The level of direct audit partner engagement with the audit client.

- Q.2 Are there pressures that could compromise the culture of audit firms that have not been identified above?

The potential consequences of the auditing profession becoming less attractive to talented individuals.

- Q.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?

If Q2 is addressed appropriately – no more to add here.

Skills and personal qualities of audit partners and staff

We would fundamentally oppose any attempt to restrict entrants to the UK profession to those possessing only 'relevant' degrees; we believe such an approach has restricted the talent pool in other jurisdictions' auditing professions and runs counter to the structure of education in the UK. At the same time we might have expected you to challenge more the apparent accepted status quo of the pyramid structure you define.

- Q.4 Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?

Yes.

- Q.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?

Yes.

- Q.6 Should there be a fundamental review of the qualifications and training requirements for auditors?

There should be a review, if perhaps not a fundamental one. We have had a concern for some time as to the reluctance of the Institutes to expand their training contract period to allow for training in an ever-expanding syllabus; consequently, the firms themselves have to undertake substantial back-filling to ensure ongoing fitness for purpose.

The Institutes need to be challenged more as to their consideration of their fundamental purpose and objectives, particularly when seen against a background of their own competitiveness with each other and their original foundation as having been inextricably linked to the auditing profession.

The effectiveness of the audit process

- Q.7 Are there other factors that determine whether an audit process is effective?

Rather than promote purely 'technical support' in 5.5 we would suggest some greater emphasis be placed on being able to access 'grey-haired' experience.

- Q.8 Are there threats to the effectiveness of the audit process that have not been identified above?

- 5 year audit partner rotation should be changed to 7 years.
- The increasing tendency of financial reporting towards fair value accounting will inevitably lead to an increasing reliance on other experts (non-accountants; non-auditors) for opinions fundamentally material to aspects of the financial statements. To the extent that this needs more explicit statement of reliance and articulated duties of care, the more diminished the audit opinion per se and the related audit process might become.

- Q.9 Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?

No.

The reliability and usefulness of audit reporting

- Q.10 Are there other factors that determine whether audit opinions command confidence?

See our responses to Q8.

Q.11 Are there other reasons why users may not have confidence in the audit opinion?

Current restrictions on communication between auditors and/or Audit Committees and users can lead to reduced confidence.

Q.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?

Enhancing the direct disclosure between the Audit Committee and shareholders and/or making the formal communication between auditors and the Audit Committee more readily available, would go some way to improving confidence in the audit opinion.

Factors outside the control of auditors affecting audit quality

Q.13 Are there other external factors that have the potential to adversely affect audit quality?

Litigation funding by third parties as a form of investment is unhelpful; this could lead to a more rigid box ticking approach which we wish to avoid in the UK.

Q.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?

This is variable between companies, and depends on the quality, experience and character of the individuals.

Q.15 Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?

This is already in existence but ultimately comes down to the quality, experience and character of the individuals.

Q.16 Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?

Yes.

Q.17 Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?

Due consideration should be given to ensuring maximising the talent pool from which Audit Committee members are derived – this may be a combination of making the role attractive enough and companies being more explicit as to their selection criteria.