

5 April 2007

J E C Grant  
Financial Reporting Council  
5<sup>th</sup> Floor Aldwych House  
71-91 Aldwych  
London WC2B 4HN

Dear Mr Grant

### **FRC Discussion Paper-Promoting Audit Quality**

The Chartered Institute of Management Accountants is pleased to have the opportunity to comment on this consultation. CIMA is a global professional body representing accountants in business. CIMA represents over 155,000 members and students in 155 countries. As such the CIMA qualification does not enable a member to perform a statutory audit. However, many of our members are involved in the preparation of financial statements which are then audited. CIMA is committed to ensuring a high standard of financial reporting and, in this respect, audit quality is key.

We do not wish to respond to the individual questions in detail, but rather to make a general comment relating to an area where CIMA and its members can be seen to have a particular expertise. It relates to Section 5 of the FRC consultation document covering the effectiveness of the audit process. To be effective, the audit has to be appropriate to the organisation concerned. This relates to International Standard of Auditing 315-Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement.

For convenience paragraph 20 of that standard is set out below.

*The auditors understanding of the entity and its environment, consists of an understanding of the following aspects:*

- a) Industry, regulatory, and other external factors, including the applicable financial reporting framework.*
- b) Nature of the entity, including the entity's selection and application of accounting policies.*
- c) Objectives and strategies, and the related to business risks that may result in a material misstatement of the financial statements.*
- d) Measurement and review of the entity's financial performance.*
- e) Internal control.*

Further detail is set out in appendix 1 of that standard

CIMA has been a long-standing supporter of narrative reporting. We were disappointed to see the abolition of the statutory Operating and Financial Review (OFR) and its replacement by the less ambitious Enhanced Business Review. It is encouraging, however, that many companies are still publishing an OFR in line with the ASB's Reporting Statement 1. Whether a company is preparing an Enhanced Business Review or an OFR it would seem that the auditor's examination of that statement is likely to enhance their ability to assess the entity and its environment. This in turn should have positive benefits for the effectiveness of the audit process.

After much debate, the role of the auditor is now restricted to checking the consistency of information in the directors' report with the financial statements. We recognise that a wider remit brings problems – the audit of a narrative report which contains subjective statements is inherently challenging, as is opining on the process of preparation. Yet narrative reporting is likely to become an increasingly important element of corporate reporting as the trend continues of increasingly complex financial statements and their inability to capture many intangible assets. We therefore suggest that the FRC keeps an open mind over the involvement of the auditor in narrative reporting particularly as it may be beneficial to the audit process itself and hence audit quality.

Yours faithfully

A handwritten signature in black ink, which appears to read 'Charles Tilley'. The signature is written in a cursive, flowing style.

**CHARLES TILLEY**  
Chief Executive