

ELECTRICITY PENSIONS SERVICES LIMITED

185 Park Street London SE1 9DY
Telephone: 020 7803 3100 Fax: 020 7803 3139 Direct Line: 020 7803 3114

JEC Grant
Financial Reporting Council
5th Floor Aldwych House
71 – 91 Aldwych
London
WC2B 4HN

30 March 2007

Dear Mr. Grant,

Comments on the Discussion Paper Promoting Audit Quality

Please find attached comments from Electricity Pensions Services Limited, central administrator for the Electricity Supply Pension Scheme on the Discussion Paper Promoting Audit Quality.

The Electricity Supply Pension Scheme is the fourth largest pension scheme in the UK, has investments of £23 billion and approximately 200,000 members.

Please contact me on the above number if you would like to discuss any of the comments in more detail.

Yours sincerely

David Sayers
Head of Finance

cc: Richard Barlow

General comments

1. The paper is generally well written and key points have been highlighted. We believe the paper correctly identifies the four main drivers of audit quality (culture, skills & qualities, audit process and quality of reporting).
2. We concur with the view that the primary purpose of an audit is unchanged but that the business environment has evolved significantly over the last 30 years (1.12).
3. We concur with the view that the audit process has become more risk based, increased reliance has been placed on the audit assessment of the control environment - supported by techniques such as analytical procedures - and that audit judgement has become even more important in relation to the statement of assets and liabilities. However, we do not believe that these changes have had a detrimental effect (1.14).
4. In terms of transparency, we would support shareholders being able to receive answers to questions addressed to the auditors at the AGM. We would not however, support investors having the right to obtain information directly from the auditors (1.19).
5. We agree that the essence of an audit report is a subjective opinion and not a definitive assertion. We agree that an audit should be designed to give "reasonable assurance" but not an absolute level of assurance (2.3 and 2.4).
6. We agree that the concentration of "blue chip" audits in the hands of a small number of audit firms (typically the big four) reduces competition (2.7) but that reflects market forces.
7. We agree that users have limited ability to assess the underlying quality of an audit, in terms of approach, evidence obtained and key judgments made. However, we would question whether this is of interest to most investors. Assurance is generally provided by the reputation of the audit firm and associated regulatory regime (2.9 to 2.11).
8. We regard the current arrangements, whereby investors only have a limited role in the audit appointment and terms of engagement as being satisfactory. We believe that this responsibility correctly lies with the Directors and Audit Committee and that the shareholders' ability to reject the appointment of the auditors at the AGM is a sufficient safeguard (2.13).

The culture within an Audit Firm

Question 1: Are there other important indicators of an audit firm's culture that are not referred to above?

9. We believe that the indicators of whether an audit firm has the appropriate culture/environment have been identified. We regard technical competence, risk management and staff training as essential.

Question 2: Are there pressures that could compromise the culture of audit firms that have not been identified above?

10. The pressures that could compromise the culture of an audit firm should be capable of being managed by any well run organisation. The winning and retention of audit clients need not result in a reduction of audit quality. Similarly, provision of good client service and technical competence of audit staff are not mutually exclusive. The provision of non-audit services is generally seen as complimentary and not a threat to audit quality. The perceived threats identified in (3.5) therefore seem somewhat exaggerated.

Question 3: Are there any other 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?

11. The key components of quality audits are: planning, technically competent staff with knowledge of the business/sector being audited open communications, early identification & management of emerging issues and proper exercise of judgment coupled with pragmatism. Generally the measures already in place ensure investors have confidence in audit firms but it is difficult to identify steps specifically in relation to building confidence audit firms' culture.

The skills and personal qualities of audit partners and staff

Question 4: Do you agree that technical skills, personal qualities and practical experience are the key drivers of audit quality?

12. We agree that technical skills, personal qualities and practical experience are amongst the key drivers of audit quality. The paper also identifies business knowledge and innate judgement skills are important qualities.

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?

13. We believe the paper has identified the issues that could result in an inadequately trained or skilled workforce for audit. However, we believe that problems in relation to the limited number of people capable of mentoring and competing calls (4.16) on their time is not limited to audit firms! We are not aware of empirical evidence to support the assertion that firms have declined to accept or act auditors to companies that are identified as high risk (4.19).
14. An issue not directly addressed by the paper is the fact that most “client facing” audit work is undertaken by unqualified staff with less than 3 years’ experience – Appendix 4 refers. We believe that this position is largely unchanged from that which has historically prevailed. However, as referred to in (1.12) the business environment has evolved significantly over the last 30 years. This appears to be a significant risk if the rate of business change continues.

Question 6: Should there be a fundamental review of the qualification and training requirements for auditors?

15. We do not believe there should be a fundamental review of the qualification and training requirements for auditors. Present qualifications are held in high regard and CPD requirements addresses post qualification development.
16. It also should be recognised that people will continue to see an accountancy qualification as a route to other opportunities (4.17) and that some staff will inevitably choose to move once they have qualified. This is not a fault of the current qualification and training regime.

The effectiveness of the audit process

Question 7: Are there any other factors that determine whether an audit process is effective?

17. We believe that the paper has largely identified the factors that determine whether an audit process is effective. Again, tight deadlines and limited availability of sufficiently experienced staff with specialist knowledge are not unique issues to audits (5.2 and 5.4).
18. We strongly agree that a firm's technical function is likely to be a valuable source of guidance particularly given increased complexity (5.5). We also strongly agree that high quality audit methodology will include documentation of the work undertaken and judgments made (5.7).
19. We disagree with the premise stated in (5.17) that the increasing role of computerisation and IT has the potential to distance both partners and staff from the company being audited. We believe that the correct use of IT for analytical review purposes will improve an audit.

Question 8: Are there any threats to the effectiveness of the audit process that have not been identified above?

20. We do not believe that the migration from "principles based" approach is necessarily a threat to the audit process (5.18) provided some flexibility and pragmatism is retained. Many aspects of audit work need to be procedurally based.

Question 9: Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?

21. We believe that current arrangements for ensuring the structure, experience and knowledge of the audit team are generally appropriate. We believe that auditors have sufficiently scope to exercise judgment. We are unable to comment on the appropriateness of audit documentation as this is not shared with clients. We believe that measures such as the appointment of ethics partners and partner rotation ensure that client capture is not a major problem.

The reliability and usefulness of audit reporting

Question 10: Are there other factors that determine whether audit opinions command confidence?

22. We believe that the factors that determine whether an audit opinion commands confidence have been identified in the paper. However, more recognition should be given to the fact that the prestige and standing of the audit firm will strongly influence confidence.

Question 11: Are there any other reasons why users may not have confidence in the audit opinion?

23. We believe that the adoption of IFRS and the switch to fair value measurement for assets and liabilities has introduced considerable benefits, particularly in terms of comparability. We do not perceive that the replacement of the traditional opinion – that the accounts show “a true and fair view” – with “true and fair view, in accordance with the relevant financial reporting framework” to be of particular concern (6.10).

Question 12: Are there further steps that could be taken to reinforce the confidence in an audit opinion? In particular, what changes to the form and present content of the audit report should be considered?

24. The key risk to confidence in an audit opinion would be further occurrence of a major corporate failure along the lines of Parmalat, Enron, etc.
25. We do not believe that major changes are required to the form and content of the audit report. The current regime is largely one of “pass” (clean audit report) or “fail” (qualified audit report). This is easily understood by users. The disclosure of additional information is unlikely to help users and is likely to confuse in many cases. Many users of accounts never read the audit report but simply take comfort that a positive opinion has been expressed.

Factors outside the control of auditors affecting audit quality

Question 13: Are there any other external factors that have the potential to adversely affect audit quality?

26. All factors appear to have been covered. Dependant upon the nature of the organisation being audited, confirmation from third parties may be necessary and this information is not always forthcoming on a timely basis.

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?

27. We believe that audit committees are discharging their responsibilities.

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

28. We believe that more detailed guidance for audit committees would be helpful provided that it is not couched or written such that it becomes a requirement.

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

29. We believe that choice on disclosure should be left to entities.

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

30. No we not consider that further steps over and above those referred to in the report should be retaken to reduce the risk that external factors may adversely affect the audit process.

31. We do not believe that the pressures caused by accelerating reporting regimes (7.15) have adversely affected audit quality. The completion of most audit work ahead of the year-end is not necessarily a problem per se and any adverse affect is compensated for by the requirement for frequent reporting.