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Our ref D187/EP4.015/PLW

Dear Mr Grant

Promoting Audit Quality

Introduction

We welcome the opportunity to comment on the FRC paper on promoting audit quality.

Before commenting on the detailed questions set out in the paper we would like to provide some overall comments on the importance and place of regulation in supporting quality and competitive advantage that provide some greater context to our views.

We should make it clear at the outset that we welcome effective and independent regulation. It is good for business and it is good for the UK and good for its competitive advantage as a world beating capital market.

The UK capital markets are currently world class in their attractiveness. The consequence is that London is a pre-eminent centre for the world's financial services industry. It has rapidly become the most attractive capital market in the world. This is of enormous benefit to the UK economy.

With this position goes a requirement for London to be a centre of excellence for all those activities and support services that will at least maintain it and, if possible, improve on it.

One of the key drivers for success is high quality auditing, which enhances the reliability of financial reporting and therefore of the functioning of the capital markets. To suggest otherwise is to ignore the lessons of history in the UK and the US, some of which are very recent. Another is that the audit profession sits within a high quality accounting profession that understands business and the capital markets. A profession that attracts and retains the right people with the courage to provide the right advice to the right clients. This is achieved only if their intellect and knowledge, supporting their opinions and advice, remains world class.

The effect of regulation and regulators can be constructive and supportive to the reputation of capital markets or it can be extremely damaging. It is necessary only to look at how quickly the US capital markets have lost their attractiveness to understand this fact. Over regulation of financial reporting and auditing with a perceived excessive total cost burden to companies and auditors has made companies and indeed auditors vote with their feet and leave that market in favour of London.

Regulators must set their agenda to address clear need and avoid setting an agenda just because it seems a good idea. There should not be a regulatory forward order book just to keep regulators busy. We do not believe that the case for additional or extended audit regulation or related initiatives has been made. Indeed we are very concerned that current initiatives and projects, including in the international arena, will have damaging long term consequences to audit quality in the UK and worldwide.

There seems to be a general acceptance amongst standard setters and regulators of accounting and auditing that convergence and uniformity of standards is something to strive for as a prerequisite to successful capital markets. That assumes that the direction of travel is right.

Much is made of the principles versus rules debate. This is relevant to the separate streams of regulation for companies, financial reporting, auditors and the capital markets. It has become acceptable to pay lip service to the attractiveness of principles whilst covertly adopting or proposing to adopt an ever extending set of rules to establish compliance with principles. The result is an ever increasing prescription that strains out the use of knowledge and judgement, has a dangerous potential to push form over substance and erodes competitive advantage based on real quality.

In our view the most significant factor in delivering consistently high quality is the quality of people at all levels of an organisation. With the right people an organisation will produce the right leaders, the right culture and the right quality. If the quality of people declines then inevitably quality will decline and no amount of process and paper will cover the cracks. This is as true of the auditing and accounting profession as it is in the wider financial and business community. Because of the very large contribution made by the UK

accounting profession to the pool of high quality accounting talent available to UK Plc., the quality of the people entering the profession assumes particular importance.

It should be a key objective of regulators to set an environment for quality that is also consistent with attracting the brightest graduates to join and remain within the accounting and auditing profession. This environment includes the ability to use their professional skills and knowledge to the full and to be competitively rewarded for this as against alternative opportunities. Quality is therefore dependent on the state of health of the profession. This will depend on the state of health of its people, its products and its rewards.

There appears to be an assumption that quality will only be achieved through regulatory intervention. No one has a greater interest in achieving quality than the partners in the audit firms who have invested not only their personal capital but also their personal reputation not simply in their own actions but in those of the whole of the partnership. The reputation of the firm, which is entirely dependent on the quality of its work, is the single most valuable asset of the firm and its partners and any suggestion to the contrary is misunderstanding fundamentally the nature of a partnership.

Key concerns

We support the contribution of the paper to achieving greater and more consistent understanding of audit quality, and we consider the paper has successfully identified the principal drivers of quality. However, we do not think the paper has given sufficient rating to the different drivers and we consider there is inadequate consideration of the relationship between an auditor and company management (see our response to question 7). We also regard some of the perceived threats as being theoretical and not real and therefore some of the implied responses potentially damaging to long term audit quality.

In summary our key concerns are:

- The discussion paper fails to appreciate the very real interest that audit firms themselves have in obtaining the highest quality.
- The FRC should ensure that it does not take action that will reduce the attractiveness of the auditing profession to the brightest and best people as they are the foundation of audit quality. Any action which damages the attractiveness of auditing as a career to the UK's brightest graduates should be resisted.
- We regard the call for a fundamental review of training to be well intentioned but woefully misguided and we believe this could negatively affect the position of the

UK profession.

- Regulators of the audit profession need to reaffirm and demonstrate that their approach supports the principles based regime that allows auditors to get on with auditing and making judgements.

As rehearsed in the FRC paper itself, the Government sponsored Co-ordinating Group on Audit and Accounting Issues (CGAA), Final Report to the Secretary of State for Trade and Industry and the Chancellor of the Exchequer, dated 29 January 2003 concluded, “the UK can claim, with some justification, to be at the forefront of best practice..... business and the professions have much to be proud of, and the great majority carry out their work with honesty, professionalism and skill.”

Since the 2003 report the entire regulatory framework for the audit profession, both in the UK and globally, has been dramatically overhauled. In addition, there have been substantial changes in the UK to financial reporting, corporate governance and company law. Many of the changes which will result from these developments have yet to flow through; indeed, most of the company law changes have yet to be implemented. In our opinion it is of crucial importance to the audit profession and the clients whom it serves that the effects of all these changes are properly analysed and understood before any further changes are proposed.

The fundamental driver: People

Although much of auditing involves the application of procedures, ultimately, it is about the application of judgement. Since judgement has to be exercised in an increasingly complex business environment, audit quality fundamentally depends on the ability of the profession to be able to recruit, retain and motivate a sufficient number of the brightest and best students. Throughout most of the 20th century, the UK accounting profession was successful in this respect, far more so than many other parts of the world. The UK Graduate Careers Survey from High Fliers Research published in May 2006 listed accountancy in the top five career destinations for the class of 2006 (with application levels for accountancy increased from 2005).

However, evidence gathered by PwC in 2003 on trends and issues in graduate recruitment into the auditing and accountancy profession in US, UK, Germany, Netherlands, Australia and France showed that there were signs of widespread concern amongst the professional bodies and PwC recruiters over a steady decline in the attractiveness of accountancy and auditing to potential recruits and degree students over the past decade. Only in the UK and Germany was there little evidence of erosion in the quality of intake to date although the concerns remain.

While this success continues, research conducted¹ shows that auditing as a career has been made less attractive by the many changes which have occurred in recent years. Key conclusions include:

- 90% of respondents considered recruitment/retention of high quality staff as the most significant issue to the future of the audit profession.
- 70% felt that the rewards of being an auditor are increasingly outweighed by the risks.
- 67% felt that, compared to two years earlier, a career as an auditor is now less attractive.
- 41% felt that changes in the accountancy profession that have occurred 'post-Enron' made them more likely to think about leaving the audit profession.

The need to keep auditing an attractive career is compounded by continuing competition for talent in the market place. This was highlighted recently by the Law Society when launching their project on staff retention and job satisfaction when they stated, "Across the legal, accountancy and investment banking professions, there is a 'war for talent'."

Academically able but pedestrian people, however well trained, will not be equal to the task; auditing requires very bright people, who then must be well trained and skilled for the work they will be doing. Although auditing in the UK remains an attractive career option for talented students, the profession is at a tipping point. The FRC needs to be careful that it does not, by its inadvertent actions, push the attractiveness of the profession beyond the tipping point, so that more of the talent moves elsewhere. Once the profession has lost the ability to recruit and retain the people it needs, experience suggests that it is impossible to reverse this other than in the long term if, indeed, ever.

Core values

Audit professionals start their careers in the knowledge that they will have to undergo formal examination and meet continuing development standards for the rest of their careers; they recognise that they have personal reputations to maintain and those who become partners will have invested both reputationally and financially in their firm. This process often takes many years and people who embark on this journey take a long term

¹ The Auditor Career and Working Life Survey commissioned by the European Contact Group and conducted by MORI (Market & Opinion Research International), an independent market research company based in the UK in 2005.

approach to their professional lives. This approach increases the level of personal responsibility of an individual.

As a result, the ethos of the people who are involved in audit is a long term one which allows them a strong focus on core values such as acting professionally, doing business with integrity, considering reputation, the ethical dimensions of actions and the ways in which they work. We do not consider this has received enough recognition in the paper.

Skills

As already said, the audit profession requires talented students. It is then important to equip those who choose to enter the profession with the necessary skills to become a good auditor. These skills are diverse and include technical auditing and accounting knowledge, but they also include a large number of other skills. In the area of training we have some serious concerns with the approach taken in the paper.

For an auditor to be effective he/she must be capable of identifying and assessing different audit risks and must be respected by those leading the companies being audited. This means that a real understanding of every aspect of a company's business – its markets, technology, people and management, as well as its finances – is vital. Auditing necessarily involves working with a company's management to build a deep understanding of their business, people and processes and so auditors must be as good at forming relationships as they are at analysing and interpreting information in accordance with accounting and auditing standards. For this reason it is important that training for auditing is not confined to rote learning and testing through formal examination. An auditor has to apply proper professional scepticism but must be capable of empathising with, as well as questioning and engaging with, management and others working in the company. Therefore, business and relationship skills are important to audit quality. There is insufficient focus in the paper on the positive value an auditor's broad business knowledge and relationship with the company contributes to audit quality.

The current professional qualifications have been developed over time with great care and considerable effort. The major professional institutes have relied heavily on academia to inform the development of the qualifications, as well as on extensive research and consultation with students, business and the profession. Over the past ten years or so, there has been a significant move away from rote learning of lower skills into higher level skills, which demand a far deeper understanding. The current qualifications place auditing in the real world business context. For example, the advanced ACA case study is both more relevant and more demanding than the advanced auditing paper it replaced. We are concerned that the FRC appears not to understand these developments and wishes to go back to an approach which may have worked well in an earlier, less complex, time but which would not be effective in the modern world.

It is not clear that the FRC has understood that the UK qualifications are generally recognised as the best in the world, nor has it understood by what journey this has been achieved. The ACCA is the leading qualification in many parts of the world. The ICAEW, ICAS and ICAI have, together with the leading professional bodies in France, Germany, Italy and The Netherlands, founded the Global Common Content Programme, and rapid expansion of this “gold standard” is expected both within and outside the EU. The UK cannot afford to be driven off the rails by a misguided and ill informed “fundamental review of the qualification and training requirements for auditors”. It is entirely unclear to us what call for this and no evidence has been provided to support the need for this statement.

Maintaining an attractive profession

As previously stated, and as the FRC recognises in its “Draft Updated Regulatory Strategy and Plan and Budget 2007/08” auditing must provide a rewarding career thus attracting, developing and retaining high quality entrants for the long term sustainability of the profession. Not only do we consider that the discussion document gives insufficient weight to this, but also we believe there are two significant threats to this attractiveness that should receive greater attention:

1. The effect of increasing regulation on auditing; and
2. The negative implications of failing to provide a broad range of experience to auditors.

Whilst we fully support the current regulatory structure in the UK, we are concerned that the trend towards ever increasing amounts of process compliance is damaging the audit profession. There is a risk that the UK is increasingly moving away from a principles based approach to a rules based approach, which will not achieve any improvement in quality; rather the reverse.

As we have mentioned earlier, a broad range of experiences helps auditors understand business. It also helps to maintain the attractiveness of a career in auditing.

The attractiveness of the profession is also vital to the wider economy. Research conducted on the FTSE 100 in 2005 by Heidrick & Struggles, the executive recruiters, found that 38% of the chief executives in the FTSE 100 had a finance or accountancy background. It is important to the quality of corporate reporting and auditing that accountants continue to fill senior positions.

The current environment

The discussion paper comes at a time when confidence in the UK's capital markets is strong: the FRC noted in its "Draft Updated Regulatory Strategy and Plan & Budget 2007/08" that the independent survey of stakeholder confidence in corporate reporting and governance in the UK suggests that levels of confidence remains high. 76% of investors were very or fairly confident in auditing of UK companies in 2006 with 96% of directors and auditors expressing the same level of confidence. This important factor should not be lost and we have concerns that the discussion paper appears to go much further than identifying the drivers of and threats to audit quality and is actively creating a platform for further regulation at a time when no case or need has been established. We are concerned that actions that will arise from the paper risk straying from the FRC's stated approach that "a well-informed market is the best regulator". If this happens there could be consequences that negatively affect the drivers of audit quality identified in the paper for generations to come.

A common interest in quality

There is a shared interest in audit quality between the audit firms and the FRC because of the significant part of the firms that auditing represents and the consequent effect on overall reputation, both of the firms themselves and of their partners and staff. Indeed, no one has a greater interest in audit quality than the partners in the audit firms.

The importance of quality at PwC is highlighted in a number of places, including our vision:

We aim to be the leaders in our chosen markets by serving our clients through relationships based on quality and integrity in everything we do and being a great place to work for all our people.

We aim to deliver our goal by putting quality, integrity and relationships at the heart of the approach to the work we do. This drives our recruitment policies, the structure of the Assurance Leadership Team and audit processes that we have in place. Auditors play a significant role in the operation of the world's capital markets. We take pride in the fact that our services add value by helping to improve transparency, trust and consistency of business processes. We strive for continuous improvement. Not to do so would be neglecting a large part of our business and contrary to our vision.

Taking quality seriously

The culture within an audit firm is a key determinant of audit quality. Each firm will express this in its own way, for example, PwC's code of conduct gives insight to our approach to our business:

- Acting professionally;
- Doing business with integrity;
- Upholding our and our clients' reputations;
- Treating people and the environment with respect;
- Acting in a socially responsible manner;
- Working together and thinking about the way we work;
- Considering the ethical dimensions of our actions.

This highlights the personal investment that people at PwC have in the approach to their work. It is more than following standards and complying with regulation. It is about doing the right thing and feeling proud of the work we do. This is a significant driver of audit quality. It is not something that can be regulated or easily measured, but at PwC it helps drive the competencies against which staff are assessed and each individual's progression is determined.

It is also our commitment to quality which drives the amount that the firm invests in market quality issues. We provide staff for internal technical departments as well as externally: for standard setters and regulators, for promoting interaction with institutes and for other roles of public importance relating to matters of quality. This helps us to promote a culture that values quality.

The need for regulation

At the same time as recognising the strength of the current regime, we acknowledge that there were failings, particularly in the years leading up to the creation of the FRC in 1992.

Increased regulation over the past 15 years has meant that audit partners have become more concerned than ever in demonstrating the highest standards of financial reporting and auditing, risk management and independence. Further changes are imminent, including the introduction of 36 new International Standards on Auditing. We are concerned that too much regulation risks auditors becoming overly mindful of compliance with process, which may detract from the thoughtfulness of audit work that is required. Before further regulatory burdens are imposed, recent changes should be allowed to settle so that they can be evaluated. Only if a clear need for further regulation can be demonstrated, based on the available evidence, should it be contemplated.

Whilst we do not believe that there is a need for further regulation, we do think that there continues to be a need for better understanding between the participants in the corporate reporting chain of each others' roles, especially in relation to fraud. The continued lack of understanding risks undermining confidence in audit quality. The profession globally is trying to provide some transparency and clarity and the FRC in the UK could make an invaluable contribution to this effort and build on the report commissioned by International Federation of Accountants in 2003² which highlighted each of the participants in the corporate reporting chain.

The effects and potential unintended consequences of regulation, is underplayed in the analysis offered by the consultation paper. Recent experience from elsewhere in the world has demonstrated the harm that well intentioned regulation that is not grounded in a thorough factual analysis and appreciation of the effect of the regulation can have in practice. In our view the FRC's adherence to evidence based regulatory policymaking over the past 15 years has simultaneously improved the quality and effectiveness of the UK regulatory environment and enhanced confidence in UK corporate governance and financial reporting.

A principles and evidence based approach to regulation

A light touch, principles based approach to regulation is fundamental to both confidence in, and the economic success of, capital markets. Auditing plays a key role in establishing confidence in financial data which is one of the drivers of confidence in the capital markets. Anything which damages this confidence could have a significant adverse consequence, not just for the capital markets, but for the UK economy as a whole.

This approach is one that has been led by the UK for some time and contributes directly to the UK's competitiveness in the global arena. Research commissioned by the Corporation of London in 2005 (The Competitive Position of London as a Global Financial Centre, Z/Yen Limited) showed the availability of skilled personnel as the most important competitive factor (with which we agree), followed by the regulatory environment of a financial centre. The report highlights the principles based approach and the flexibility of the regulator as particularly important factors to competitiveness. It is important that this approach is maintained for as long as it is proving effective.

This view is also supported by Ed Balls MP, Treasury Minister, who said in 2006, "I believe we are right to avoid prescriptive, heavy-handed regulation in Britain." He went

² Rebuilding Public Confidence in Financial Reporting: An International Perspective was developed by the Task Force on Rebuilding Public Confidence in Financial Reporting, an independent group commissioned by the International Federation of Accountants to address, from an international perspective, the loss of credibility in financial reporting and approaches to resolving the problem.

on to say, “we must keep the UK’s regulatory system at the cutting edge – the best in the world. Demands for higher standards of probity – and for greater protection for investors – never cease, and we will judge these demands on their merits. But at all times we will apply a principled system of risk-based regulation, without unnecessary administrative burdens.”

We continue fully to support high and appropriate standards and external and robust regulation of the auditing profession, however, we are concerned that the approach of the oversight functions within the FRC, specifically the Audit Inspection Unit (AIU) risk having a detrimental effect on audit quality. A principles based regime is only effective to the extent that it is regulated by a principles based regulator. Unfortunately, the AIU’s actions have not always promoted such an approach and we believe that a lot could be learned from the approach of the Financial Reporting Review Panel (FRRP). The approach of the regulator has a direct effect on the culture of an audit firm and a relentless focus on documentation will drive a culture in the audit firms that detracts from evidence gathering and making judgements.

Conclusion

In conclusion we are firmly of the belief that, whilst mistakes were made in the past so that financial reporting and audit quality needed to improve, lessons have been learnt and standards put in place that have had an important effect on the profession and other participants in the corporate reporting chain. We welcome the work of the FRC and suggest that they continue to explore the need for better understanding among the participants in the chain of each others’ roles but that any proposed changes should be evaluated once the recent changes affecting the regulatory environment have had a chance to take effect.

We are also keen to understand what the FRC intends to be its next steps. In our opinion, there is no evidence which supports the case for significant further regulation and we would welcome a discussion on future intentions once the responses to the discussion paper have been considered.

Responses to specific questions

Q1. Are there other important indicators of an audit firm’s culture that are not referred to above?

No.

The indicators included in the paper highlight the principal themes of an audit firm's culture; however, we believe that this needs to be put into context. The culture within an audit firm cannot exist in isolation of the general business culture and in society. It is the responsibility of auditors to promote a culture of audit quality within their organisations; it is then the responsibility of others to recognise that this is the case and value the audit. This includes the way that audit committees work with the auditors and the way that regulators set the environment in which the auditors work.

Q2. Are there pressures that could compromise the culture of audit firms that have not been identified above?

Yes.

The effect of regulation on the culture of a firm is not discussed in this section. The approach of the regulator has a direct effect on the culture of a firm. If a regulator takes a rules based approach to the oversight of audit firms, firms will emulate this approach to their audits. As noted above, we have concerns that the FRC is taking this approach to oversight of the audit firms and that this is having a damaging effect on their culture. This approach specifically damages two areas:

1. It diverts attention from the principles underlying auditing and ethical standards. If the regulator uses these standards as a check list for compliance, then the firms will be forced to take that approach to their audit. This will detract from focussing on the underlying principles, which is fundamental to consideration of whether or not the accounts show a true and fair view.
2. It forces auditors to spend increased amounts of time focussing on audit documentation to the detriment of the audit work itself.

Ability to recruit the best people has an effect on culture. The culture of integrity and professionalism, as well as technical competence, is dependent on the ability to attract the brightest people into the profession. The paper has not given enough weight to this.

A further threat to the culture of an audit firm is taking actions that undermine the ability or willingness of the audit teams to exercise judgement. It is important that decisions in relation to an audit are made by the teams who are in the best position to understand the company. This must be done after consulting, to the extent that is appropriate. It is important that the profession continues to develop people capable of making difficult judgements. Second guessing of judgements made by auditors with the benefit of hindsight undermines the whole concept of the audit and its attractiveness as a career to the best people.

Q3. 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?

Yes.

As noted above, we believe that there is need for better understanding between the participants in the corporate reporting chain of each others' roles which, if not considered, could undermine confidence. The FRC is in a unique position to bring together all of the relevant parties to address this deep rooted and long standing problem.

Q4. Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?

Yes.

Q5. Has the 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?

No.

The paper has identified some theoretical risks to the training and skills of the audit workforce. We are concerned that in identifying such theoretical risks, the FRC has given the impression that they are real risks which thus need to be addressed. Furthermore, we do not believe the FRC has properly understood the nature of the current professional qualifications and appears to be applying an understanding which is out of date to the present situation.

As stated, the FRC has identified theoretical risks. The real risk, however, is if auditing is not considered to be an attractive career option for the best people. Without the best people being attracted and retained the issues that have been identified will be largely academic. We believe that the FRC needs to apply its attention to this vital consideration.

Q6. Should there be a fundamental review of the qualification and training requirements for auditors?

No.

Significant amounts of work have been done, in consultation with educationalists and practitioners, to generate in the UK what are widely regarded as world-leading professional qualifications.

Only last year IFAC developed and released International Education Standard 8, 'Competence requirements for audit professionals'. The Institutes continue to update and improve the training offered; indeed the ICAEW is making changes to the ACA qualification from 2007. But these changes are incremental and build on the extensive work that has been conducted in the past. By its nature, a fundamental review is not incremental. We are concerned that the work of the profession during the 1990s has not been recognised by the FRC, which had led it to suggest that there is a need for a fundamental review when, in reality, this work has already been done and has been incorporated for some years now in the current professional qualifications.

A fundamental external review risks undermining the accounting qualifications, particularly when the process of common content has just aligned the qualifications of institutes in France, Germany, Ireland, Italy, The Netherlands and the UK.

Q7. Are there other factors that determine whether an audit process is effective?

We think that the paper identifies most of the factors that contribute to an effective audit process.

However, we would add to these the relationship that an auditor has with the Board of Directors, the audit committee, the financial management and elements of the operational management. A close, robust and challenging relationship with these parties will improve the effectiveness of the audit. A distant, difficult and uncooperative relationship will create significant barriers to audit quality. Inevitably the quality of these relationships is difficult to assess and measure from a distance. The reforms in 2003 went some way to recognising this in establishing the responsibility of the Audit Committee for managing the relationship between the Board and the auditors.

As a more minor point, we would expand the section on appropriate technical support to include consultation with others in the firms more generally, and not just in technical functions. There is a wealth of other expertise, for example industry knowledge, that may not reside in the technical departments and this should not be overlooked. The audit process should promote consultation without the need to be prescriptive as to where this is to be found.

Q8. Are there threats to the effectiveness of the audit process that have not been identified above?

We believe that all of the significant threats to the audit process have been identified.

We are confused by the emphasis on computerised audit methodologies, as we do not consider that the issue is with the medium of delivery of the methodology or the effect of the use of IT on quality per se. We accept the point that is being made about time spent in the audit room but feel that this is driven by other factors, for example, the relentless pace of change and increasing complexity of the reporting and auditing environment and the focus on documentation.

Q9. Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?

No.

As already noted, companies and auditors have had to deal with unprecedented levels of change over the past five years. We believe that now should be a period of consideration to enable these changes to bed down and their effect to be properly evaluated both by the FRC and the firms themselves. The IASB has recognised the burden of recent change and has agreed that no new standards will be effective before 2009. We believe that the FRC should ensure that no further changes are made to the regulatory regime for the same period other than those that are required by European or domestic legislation, for example, International Standards on Auditing redrafted under the Clarity Project, or in response to an urgent and clear need.

Q10. Are there other factors that determine whether audit opinions command confidence?

Yes.

We believe that the reputation of the audit firm that has carried out the work may affect confidence.

Better communication between the audit committee and the shareholders will also help an audit opinion command confidence. We believe that the Smith Guidance has gone a long way to helping to achieve this.

A greater understanding of the practical implications of the audit process for the company will help to increase transparency and should help to expose, and then remedy, different understanding of roles between participants in the corporate reporting chain. The work of the Audit Quality Forum is helping to achieve this.

Q11. Are there other reasons why users may not have confidence in the audit opinion?

Yes.

A move from principles based auditing standards to rules based standards would directly and adversely affect confidence in the audit opinion. We therefore support the work of the APB in promoting principles based standards.

Q12. 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?

We support continuing the debate that has been started by the Audit Quality Forum's paper on this topic.

Q13. Are there other external factors that have potential to adversely affect audit quality?

Yes.

As mentioned in the audit process section of the paper, standards setters have the potential to adversely affect audit quality if they stray from a principles based approach to a rules based approach.

Q14. 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?

As mentioned in our response to question 7 we regard the Audit Committee, as the proxy for the shareholders, as the custodian of the quality of the relationship between the auditor and the Board.

To the extent that the responsibilities of Audit Committees are described in the Combined Code and the Smith Guidance, we believe that the audit committees of the largest companies are discharging their duties effectively and that this is setting the example for smaller listed companies to follow, which we believe they are doing. In our experience, in general, Audit Committees have become stronger and more questioning and have worked closely with auditors.

Whilst we would support further investigation of these issues as a matter of better understanding the current practices of audit committees in the UK, we think that the market

should be allowed to develop naturally in this area. Allowing the market to regulate itself is the approach in the Combined Code and the Smith Guidance. The activities of the Audit Committee are an example of when codified definitions would be inappropriate because they differ based on the size, complexity and risk profile of the company.

Q15. Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?

We are not aware of any demand or need for further guidance, as there is already information and guidance available to audit committees from different sources, helping to maintain a principles based approach. If the FRC were to issue further guidance there is a risk that it will be perceived by audit committees as rules.

Q16. Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?

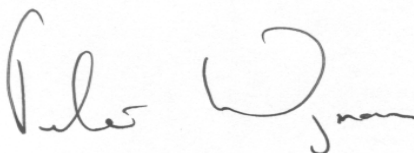
We believe that this type of disclosure in the annual report will only increase transparency if it is meaningful and specific to the entity. We would support disclosure becoming best practice, but do not consider that it should be mandated since this risks creating nothing more than boiler plate disclosures.

Q17. Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?

Yes.

As we mention earlier in our response, we believe that a better understanding between the participants in the corporate reporting chain of each others' roles will help to ensure that the risks of external factors affecting the audit process are properly identified.

Yours sincerely

A handwritten signature in black ink, appearing to read "Peter L Wyman". The signature is fluid and cursive, with the first name "Peter" and last name "Wyman" clearly distinguishable.

Peter L Wyman

