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Dear Ms Trickett

Reporting on Audit Quality Monitoring

We have read with interest the consultation document on this subject, issued in June 2006. As one of the firms that are visited and reported on each year by the AIU, we understand well the advantages and disadvantages of public reporting set out in the document. We also recognise that monitoring can help provide assurance to stakeholders that the necessarily confidential process of auditing is working effectively. We therefore think that it is important that the findings of the AIU are published in an appropriate form, in the public interest.

However, the work of the AIU is only part of a strict regulatory process for the registration of auditors. This has worked well for many years and has ensured that only firms that are fit to act as company auditors do so. Until recently, the individual supervisory bodies with which audit firms were registered carried out the monitoring. Now, it is carried out by a combination of the supervisory bodies themselves and the AIU, reporting to the supervisory bodies' audit registration committees. There has been an annual public report on the findings of the monitors, which has not named individual firms. Nevertheless, firms that did not respond appropriately to the findings of the monitors have been deregistered.

We set out below our comments in response to the questions in the consultation document. We would emphasise that our comments are born out of a consideration of what different forms of reporting would achieve and what they would not. This firm would, we believe, only benefit commercially from publication of AIU and QAD reports on individual firms. While superficially therefore it might seem that we would obtain competitive advantage from the publication of reports on individual firms, for the reasons set out below, we do not believe that this would be in the public interest and we do not therefore favour it.

We believe that the sole aim of the AIU's monitoring regime and any reporting should be the improvement of audit quality among both individual firms and the profession as a whole. Care must be taken to ensure that reporting does not achieve the opposite result.

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Question 1

To which of the arguments set out in Part 5, for and against extending public reporting of AIU inspection findings, do you attach most weight and why? Are there other important arguments which we have not captured?

We believe that if there were to be extended public reporting, the whole nature of the AIU's work and reporting would have to change radically. This is because at the moment the process is designed to identify areas where performance could be improved. It is therefore effectively an exercise in measuring a firm against a standard based on perfection and reporting matters where the firm does not achieve this. For public reporting to have any value to audit committees and other stakeholders, reports would have to identify areas of good practice by firms and report on these as well as on failures to meet a standard of perfection.

Unless public reporting is radically turned round to give an assessment of a firm's overall capability, including good as well as bad practice, we attach little weight to the arguments that it would provide greater transparency or decision useful information to audit committees.

We offer no comment on whether it would help investors reach a more informed view as to the appropriateness of a non Big 4 firm acting as auditors. This is a question for investors to answer.

We are also not persuaded that it would further incentivise firms to show year on year improvements in the quality of their work. There are already very strong incentives continuously to improve quality. In reality, the drive to do this comes from firms' desire to meet clients' needs, to maintain their reputation and to avoid regulatory action. We also believe that it might divert firms' efforts from trying to do better work to trying to achieve a report with fewer comments about non-compliance. All of the major firms are likely to be good judges of what constitutes real audit quality and we, no doubt like others, do not believe that it is necessarily the same thing as achieving a short report from the AIU.

As to the practical difficulties of grouping together findings from a number of firms, the people who actually need to know how each firm performed are the audit registration committees of the supervisory bodies, who have to decide whether firms should continue to be registered and, if so, on what conditions. They already get this information about each firm. We do not believe that it would help their deliberations to know that they were being second-guessed by the public and the press.

On the other hand, we attach great weight to the first disadvantage listed in the paper i.e. that firms would be likely to adopt a more defensive approach to inspections. The current regime is highly rigorous yet characterised by constructive relationships between regulator and regulated. This is essential if the regime is to improve the standard and quality of auditing.

It seems to us that changing to public reporting on individual firms would reflect badly on the current regulatory regime, including the AIU. It would effectively be saying that the public do not trust POB and the AIU to look after the public interest in the most effective way they can. On occasion, we would expect the AIU to have to be quite aggressive with a recalcitrant firm that would not make a change that is clearly necessary. On the other hand, they will generally be more effective in achieving change within firms if they work with the firms to find the best way to bring that change about, consistent with the firm's culture and history. Increased public reporting on individual firms may result in the AIU having to work in a confrontational environment and make the relationship between it and the firms less productive in terms of beneficial change.

We do not find convincing the argument that allowing firms to correct weaknesses based on private reports but threatening publicity if appropriate remedial action were not taken would provide a stronger incentive. For the reasons given above, we believe there are already strong incentives for firms to achieve high quality audits. Also, all registered audit firms already know that failing to honour undertakings they have given to the audit registration committees are taken extremely seriously and the prospect of publicity would not make it any more compelling.

We agree that the process would be likely to become more legalistic. Firms will feel bound to ensure that they are not criticised in public unless that is absolutely fair, both in terms of their culpability and in terms of the gravity of the matter compared to matters being reported or not reported about other firms.

We also agree that it is likely that the inspection process would become more focused on compliance and less on quality, as the former lends itself to finding unarguable points, even if they are less important. It would also lead to auditors spending their time ensuring that they could not be criticised for non-compliance, by endless form-filling rather than thoughtful auditing. This is especially so now that the number of rules with which auditors have to comply has exploded over recent years. There would be plenty of scope for auditors to spend their entire time demonstrating compliance with a multitude of rules rather than doing any useful auditing at all.

We agree with the points made about reports being likely to be less timely. However, we do not attach great weight to these arguments because, for the reasons above, we do not consider public reporting useful. It is not therefore of great concern to us when it happens.

Question 2

Which of the options set out at para 6.1 below do you favour, and why? In particular, do you share our view, set out at para 6.2 below, that the nature of weaknesses at a named firm should be disclosed only after the firm, in the opinion of the Oversight Board, has failed to respond positively and promptly to recommendations made to them by the AIU?

We favour option A, mainly because the current system appears to be working. The public report issued in July 2006 shows clearly that firms are responding to points raised by the AIU. Any attribution of weaknesses to individual firms would be bound to attract many of the disadvantages set out in section 5 of the paper and commented on above.

However, we also note that the list of options did not include the publication of a fuller assessment of individual firms' positive as well as negative abilities. In our view, this is the only way public reporting can be made to have a positive impact on the profession.

Question 3

Do you think that information from AIU inspections on individual audit firms and/or their audits of individual companies should be made available privately to audit committees? If so, what do you think is the most appropriate way of achieving this?

We find it hard to envisage how this could be done without the reports becoming public knowledge. It therefore suffers from all the disadvantages above. In particular, as discussed above, reports that only comprise a list of non-compliances are of very little use to audit committees, who are equally interested in what firms do well, not just what they do poorly.

The aims of audit committees and of the AIU are quite different. The aim of audit committees is to identify auditors who will provide maximum assurance to shareholders on the truth and fairness of the view given by the company's financial statements, while also providing feedback to the committee on management and on the company's affairs more generally. The aim of the AIU is to provide evidence to the supervisory bodies to help them ensure that only firms that are fit to act as company auditors do so.

It is worth noting that at present firms are forbidden by the AIU from revealing to clients the content of reports or even the fact that the AIU has inspected a particular audit.

Question 4

How would you quantify the costs and/or benefits of the options set out at 6.1 below, taking into account Annex A?

We have no comment on the additional cost estimates given in Annex A in respect of Options A or B. In respect of Options C and onwards, however, we fear that the additional costs may be far higher than estimated. There would be costs both for the AIU itself and serious costs for firms both in senior management time and in legal costs, ensuring that information published were fair.

Yours sincerely

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