

# Smith & Williamson

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SW:

22 September 2006

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Dear Ms Trickett

## **Reporting on Audit Quality Monitoring – a consultation document**

Smith & Williamson Limited welcome the opportunity to respond to your request for comments on “Reporting on Audit Quality Monitoring”

As a “mid tier” firm with a very small number of audits falling within the remit of the AIU we, together with a number of similar sized firms, have yet to be subject to review. We have been led to believe that for firms of our own size the approach may differ from the Big Four and certain other larger firms particularly in respect to the interaction with the Quality Assurance Directorate. However we strongly support anything that will raise public confidence in auditors and believe it is an opportune time to be seeking wider consultation on public reporting given the recent publication of the Oxera Report.

Yours faithfully

**Smith & Williamson Limited**

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## **RESPONSES TO SPECIFIC QUESTIONS**

### *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?*

#### **Provision of decision useful information to audit committees**

As discussed below we do not support the private provision of information to audit committees or the publication of reports commenting on the results of specific file reviews. However we consider that access to further information on the quality of audit work performed by specific firms may assist audit committees in carrying out their responsibilities. The information will be particularly relevant when considering appointment and reappointment of auditors and possibly in respect of specific aspects of the conduct of the company's audit.

We would suggest that audit committees would need to have access not just to information about their current auditors but would also have access to the same information about other audit firms so as to benchmark the current auditors and make an informed decision as to whether to recommend a change in auditor.

The benefit of audit committees (and the wider investor community) having access to more detailed information on the quality of individual firms audit work may be of particular relevance to "mid tier" firms. As highlighted in the recently issued Oxera Report on Competition and Choice in the UK Audit Market all but one FTSE 100 company and the majority of FTSE 350 companies are currently audited by a Big Four firm. We believe that the AIU reports will illustrate that mid-tier firms are capable of producing good quality audits for companies of comparable, or near comparable, size and the availability of this information should encourage audit committees and investors to consider appointment of auditors outside the Big Four.

#### **Help investors reach a more informed view on the appropriateness of a non Big Four firm acting as auditors of certain types of listed entities**

We would refer you to our comments above.

#### **Give firms an incentive for improvement**

Under the current system, firms are already incentivised to perform audits that comply with auditing standards through the reporting process between the AIU and ARC (or equivalent body) and the possibility of subsequent deregistration if a firm does not comply. However we do think that a system of "naming and shaming" those firms who do not implement the AIU's recommendations will be a further incentive for improving audit quality. To be effective we would also strongly suggest that the recommendations made in the reports are clearly distinguished between those that result from non-compliance with auditing standards and those that, in the opinion of

the AIU, are recommendations which would improve audit quality above and beyond compliance with auditing standards.

**Overcome practical difficulties in the current form of reporting**

The current form of reporting has only been in place for two years and in particular, some firms (including ourselves) have not yet been subject to review. However we agree that the current approach of grouping together findings from a number of firms is not ideal and does not provide particularly useful information for audit committees or investors.

**Disadvantages**

**Reports are likely to be less timely**

In relation to the timeliness of the reports, we do not agree with the view expressed in your report that it is necessary to report annually on each firm or that all reports should be published at the same time. What will be necessary is for there to be clear communication of the processes and the reasons why some firms do not have annual reviews. For firms outside the Big Four it may be more appropriate to report, for example, every 3 years. This would have disadvantages in the case of a firm who received an unfavourable report having to wait 3 years to demonstrate that they have made improvements. For this reason we would favour some element of flexibility in this timetable to enable firms to request a further visit, perhaps in the year following an unfavourable report, in order to demonstrate their improvements.

While there is a possibility that reports could become less timely and more anodyne and therefore the objectives of greater transparency could be defeated, the PCAOB have demonstrated that it is possible to publish timely reports whose content is far from anodyne or insipid. We believe that a report published within 6 to 9 months of the review taking place (as has been the past practice of the PCAOB) is well within a sensible time-frame. However a delay of anything over 12 months would certainly reduce the usefulness of the information published and would also have a detrimental impact on the work of registration committees (such as the ARC) who use the reports of the AIU in order to follow up any instances of non-compliance and determine whether a firm's audit registration should be withdrawn.

**It may weaken the essential purpose of audit inspection**

The POB needs to be wary of the possibility that increased public reporting could lead to more of a “box ticking” approach to both the audit process and the AIU's review process. Auditing standards are principles based and therefore involve judgment. Performing a review of compliance with auditing standards also therefore involves judgement. If the results of reviews are made publicly available firms may understandably call for a more “rules based” set of standards to enable them to implement an audit methodology that will ensure that all audits comply with the rules

and to increase the ease at which they can demonstrate that they are in compliance with the standards if challenged by the AIU.

There will also be inevitable inconsistencies between judgements made by different review teams while a principles based set of standards is in use and this could also increase the pressure for rules rather than principles to ensure AIU reviews are performed in a consistent manner from firm to firm. In our opinion, any move away from principles based standards would be an undesirable consequence of these proposals.

**Impact on the companies whose audits are subject to AIU review**

This will only be an issue if the individual company reports are issued or it is clear from the information published which company the report relates to (e.g in the case of an audit firm with very few companies falling under the AIU remit). As discussed below, we are not in favour of reporting on individual audit assignments.

*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 in 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?*

If it is concluded that a change in the form of reporting is appropriate we would favour Option F which restricts the publication to the main themes of the firm wide review but does not disclose details of individual audit engagement reviews. In our opinion this option achieves all of the advantages discussed above while limiting the disadvantages highlighted.

We believe that pulling together the main themes of each review rather than publishing the results of each individual assignment will reduce the defensiveness of the process and will also help maintain the timeliness of the reviews. Also publishing only information at a firm-wide level will limit the danger of adverse publicity for the companies whose audits have been subject to review and reduce the risk of litigation by these companies. However we would also strongly recommend that the reports put into context the results of the reviews, for example by stating how many files out of the total reviewed contained each shortcoming identified and reporting on the positive aspects of the firm's audits and procedures. The latter could also be a good incentive to overall improvement in audit quality.

Audit firms should be given the chance to respond to the comments before the public reporting is made and where relevant their responses should be published alongside the results of the review. In addition, it should be clear to the reader which recommendations are a matter of fact such as the absence of compliance with a specific procedure and those which relate to matters of judgement.

For firms with very few audit clients falling within the AIU's remit it may not be possible to issue a separate report for each firm as it will be easy to identify which companies the reviews relate to and therefore could have a detrimental effect on the individual companies as discussed above. However we would draw your attention to our comments under question 4 below in relation to expanding the scope of the published reports. One option may be to issue a report which is written on a group-wide basis (e.g all firms with 5 or less audit clients falling under the remit of the AIU) however this approach would have the disadvantage of grouping the results of all the firms' reviews together. Unless carefully presented this could give the impression that all the firms were of the same quality as the "lowest common denominator" and lead us back to the current position where firms with different market focus and varying quality of audit work are being reported on together.

We do not support the form of "reporting by exception" on firms only when they have failed to respond to recommendations made by the AIU as we feel that the mechanism for dealing with such firms is already in place through the powers of ARC and their equivalents. If a recommendation made by the AIU relates to non-compliance with auditing standards and the firm has failed to respond appropriately, this will be dealt with through withdrawal of their audit registration. If the recommendation is over and above the requirements of auditing standards we do not feel it is appropriate to penalise firms if they have chosen not to implement the actions suggested by the AIU. Raising quality over and above what is in auditing standards could be achieved through the reporting of best practices within individual firms.

*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 do not think that additional information should be made available to audit committees over and above that which is in the general public domain. If a report is produced encompassing the points discussed above, audit committees should have sufficient information to assess the quality of the audits performed by the current auditors of the company and any possible replacement firm. In addition there will always be a danger that some of the "private" information will inevitably become public which would create an uneven playing field for the firms and companies who were implicated by that information.

As noted above, audit committees have the option of asking specific questions of their auditors if they wish to obtain more information about their quality control processes.

*Question 4*

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

The report notes that there is no impact on small companies as they do not fall under the remit of the AIU. While this is clearly true for the smallest privately owned companies we believe that there may be benefits in extending the transparency discussed above to reports written by the Quality Assurance Directorate on the audits of some non full list entities. AIM listed companies, large private companies with diverse shareholdings and entities which receive a large amount of funding from government bodies (such as Universities and Registered Social Landlords) do not currently fall under the remit of the AIU. If there is a valid argument for extending the public reporting of the AIU's reviews then it is clear that many of the advantages will also be relevant for other types of audited entities. In our opinion this should be considered.

The report implies that the cost of the increased amount of resources needed by the AIU if further transparency is to be achieved will be passed onto the companies under their remit. In our opinion there will also be an increased amount of resources needed within the audit firms in relation to increased time spent responding to the AIU and agreeing the final content of the reports. Many firms, particularly smaller firms, may find it difficult to pass these costs onto their clients and may therefore consider withdrawing from the market for these types of audit. In the light of other discussions on audit competition, this would be an unfortunate consequence.