



AUDIT INSPECTION UNIT

PUBLIC REPORT ON THE 2007/8 INSPECTION OF BDO STOY HAYWARD LLP

8TH DECEMBER 2008

This report is issued by the Audit Inspection Unit of the UK's Professional Oversight Board ("the Oversight Board"), part of the Financial Reporting Council. It has been approved for publication by the Oversight Board.

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1 Scope, objectives and background information

1.1 Introduction

This report sets out the principal findings arising from the inspection of BDO Stoy Hayward LLP (“BDO” or “the firm”) carried out by the Audit Inspection Unit (“the AIU”) of the Professional Oversight Board (“the Oversight Board”), part of the Financial Reporting Council (“the FRC”), in respect of the year to 31 March 2008 (“the 2007/8 inspection”). Our inspection was conducted in the period from January 2008 to April 2008 (referred to as “the time of our inspection”).

It is based on the AIU’s more detailed private report on its inspection of the firm to the Audit Registration Committee (“the ARC”) of the Institute of Chartered Accountants in England and Wales (“the ICAEW”) with whom the firm is registered for audit purposes. The AIU currently inspects the largest audit firms, including BDO, annually.¹ The 2007/8 inspection was our third inspection of BDO. The ARC considers whether audit registration should be continued for the firm following each inspection undertaken. The AIU’s 2007/8 report to the ARC, which was finalised in August 2008, recommended that the firm’s registration to conduct audit work should be continued.

This is the first year the AIU has reported publicly on individual firms. In the past the AIU issued an annual public report in which the principal findings arising from its inspections of the major audit firms in the UK were dealt with on an anonymous and aggregated basis.

The AIU exercises judgment in determining those findings which it is appropriate to include in its public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to areas of particular focus in the AIU’s overall inspection programme for the relevant year.

The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review by the AIU which, in turn, reflects the firm’s client base. An issue reported in relation to a particular firm might also apply to other firms without having arisen in the course of the AIU’s inspection fieldwork at those other firms in the relevant year. Only a small sample of audits are selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm’s audit work.

¹ The Companies Act 2006, as amended with effect from 6 April 2008 by the Statutory Auditors and Third Country Auditors Regulations 2007, requires that full scope inspections of those audit firms conducting more than ten audits within the scope of independent inspection (as determined by the Professional Oversight Board) are undertaken at least every three years.

All findings requiring action set out in this report have been discussed with the firm together with the firm's proposed action plan to address them. Appropriate action may have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed by the AIU during its next inspection of the firm.

The Oversight Board undertook to publish all the reports for the 2007/8 cycle of inspections on a single date. The fieldwork at each firm is completed at different times during the year and comprehensive quality control procedures are applied before the AIU's private and public reports are finalised. As a result, there is necessarily a significant period of elapsed time between completion of the AIU's inspection fieldwork at firms and the publication of reports on the inspection findings.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix A.

The AIU acknowledges the co-operation and assistance received from the partners and staff of BDO in the conduct of the 2007/8 inspection. Our private report to the ARC took longer to finalise than was the case for other firms. We have therefore discussed with the firm how the process can be improved for the future.

1.2 Scope and objectives

The overall aim of the FRC is to promote confidence in corporate reporting and governance. One of the strategic outcomes contributing to this aim is for the users of audit reports to be able to place a high degree of reliance on audit opinions, including whether financial statements show a true and fair view. The AIU's programme of inspections is designed to contribute to the achievement of this strategic outcome.

Our inspections of the major audit firms, on which we report publicly, comprise a review of the firms' policies and procedures supporting audit quality and a review of the quality of selected audits of listed and other major public interest entities that fall within the scope of independent inspection, as determined each year by the Oversight Board.

We review firms' policies and procedures in the following areas:

- Leadership, strategy and communications
- Performance evaluation, promotions and remuneration
- Other human resource matters
- Client risk assessment and acceptance/continuance
- Consultation and review
- Audit quality monitoring

- Independence and ethics
- Audit methodology

Our reviews of individual audits place emphasis on the appropriateness of significant audit judgments exercised in reaching the audit opinion as well as the sufficiency and appropriateness of the audit evidence obtained.

Our inspections include, but are not restricted to, an assessment of compliance with the requirements of relevant standards and other aspects of the regulatory framework for auditing. These comprise the auditing standards and ethical and quality control standards for auditors issued by the FRC's Auditing Practices Board (APB)² and other relevant requirements under the ICAEW's Audit Regulations³. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken. (The APB issued revised Ethical Standards in April 2008 which are effective for audits of financial statements for periods commencing on or after 6 April 2008.)

We seek to identify areas in which improvements are, in our view, required to safeguard audit quality, including matters relating to compliance with regulatory requirements, and to agree an action plan with the firm designed to achieve these improvements. We also assess the extent to which the firm has addressed the findings and recommendations arising from its last AIU inspection.

While the AIU's public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. Our inspections are not designed to, nor would it be possible to, identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected by us for review and cannot be relied upon for this purpose.

We reviewed the quality of five individual audit engagements undertaken by the firm. These related to FTSE 250, other listed and other major public interest entities with financial year ends between December 2006 and May 2007. Our reviews covered selected aspects of the audit only. In addition, we undertook one follow-up review to assess the extent to which our prior year findings had been addressed in the following year's audit.

The monitoring units of the professional accountancy bodies in the UK who register firms to conduct audit work are responsible for monitoring the quality of audit engagements

² International Standards on Auditing (UK and Ireland). APB Ethical Standards and International Standard on Quality Control (UK and Ireland) 1.

³ The Audit Regulations are issued jointly by The Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in Ireland.

falling outside the scope of independent inspection by the AIU but within the scope of audit regulation in the UK. Their work, which is overseen by the Oversight Board, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange (“a full listing”) and whose financial condition is not otherwise considered to be of major public interest. All matters raised in this report are based solely on work carried out by the AIU.

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC, the Oversight Board, the AIU and their employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

1.3 Background information on the firm

The firm is a UK limited liability partnership and is the UK member of the BDO International global network of firms using common audit methodology and audit software.

The firm operates from 15 offices nationwide, with principal ‘business streams’ of Business Assurance, Corporate Advisory including Corporate Finance, Business Restructuring and Forensic Accounting, Tax and Investment Management. These business streams have dedicated teams of partners and professional staff nationwide.

For the year ended 30 June 2007, the firm’s turnover was £307 million, of which £97 million related to Business Assurance. The average number of employees was 2,670, including 1,064 relating to Business Assurance.⁴ There was a total of 226 partners, of whom 108 were authorised to sign audit reports, and 28 employees (audit directors) who were authorised to sign audit reports.⁵

The AIU estimates that the firm had 48 audit clients within the scope of independent inspection by the AIU as at the 2007/8 reference date of 27 February 2007. Of these audit clients AIU records show that 33 had a full listing or were listed on the AIM market of the London Stock Exchange⁶, including 5 FTSE 250 audit clients.

⁴ As disclosed in the firm’s annual report for the year ended June 2007. An analysis of Business Assurance turnover between audit and non-audit fees is not publicly available.

⁵ As disclosed in the annual return to the ICAEW as at November 2007.

⁶ The firm also had other AIM listed audit clients below the threshold for inclusion within scope.

2 Findings

2.1 Overview

Our review of the strategy and communications of the firm, together with our discussions with senior management, demonstrated the importance the firm places on audit quality.

In our view, the firm has policies and procedures in place in all relevant areas subject to our review that are appropriate for its size and the nature of its client base. In particular, the role of the central monitoring functions, including the audit quality monitoring process, enhances audit quality on an ongoing basis. We identified certain areas for improvement which are detailed in sections 2.2 and 2.3 of this report.

In relation to reviews of individual audits, we have generally reported our findings by reference to significant matters arising on one or more audits. In view of the relatively small number of the firm's audits reviewed by us, it is not appropriate to report principally on the basis of themes arising or issues of a similar nature identified across a number of audits.

We were generally satisfied, subject to our comments in section 2.4.3, with the basis on which significant audit judgments were made on the five audits reviewed by us. In our view, audit work was generally performed to a good or acceptable standard. The overall findings arising from our review of individual audits are set out in section 2.4; these include areas where improvements are, in our view, needed in order to enhance audit quality. In our view, two of the audits we reviewed, one of which related to an entity listed on a regulated market⁷, required significant improvements in certain areas.

The follow-up review we conducted showed that the issues we raised in the previous year had been addressed on that audit.

The firm has implemented the recommendations we made following our inspection last year by providing the required training and/or guidance and taking other steps as appropriate. However, certain issues recurred on individual audits we reviewed; while some of these audits may have been undertaken before the relevant training or briefing was provided, we believe that a number of these areas should remain areas of focus in the firm's training and communications.

The principal findings arising from our review of the firm's policies and procedures supporting audit quality and the quality of the individual audits selected by us for review

⁷ Within the meaning of Part VI of the Financial Services and Markets Act 2000.

are set below under three broad headings: quality control (section 2.2); independence and ethics (section 2.3); and audit performance (section 2.4).

2.2 Quality control

This section covers our review of the following aspects of the firm's system of quality control for audit engagements:

- 2.2.1 Leadership, strategy and communications
- 2.2.2 Performance evaluation, promotions and remuneration
- 2.2.3 Other human resource matters
- 2.2.4 Client risk assessment and acceptance/continuance
- 2.2.5 Consultation and review
- 2.2.6 Audit quality monitoring

2.2.1 Leadership, strategy and communications

Leadership of the UK firm is through the Management Executive, comprising the Senior Partner, the Managing Partner and other executive partners. The Management Executive team sets business strategy and ensures its implementation. The Managing Partner and each team member also have specific areas of responsibility for operational management.

The firm's strategy includes building the firm's reputation for quality work. Matters relevant to audit quality are communicated regularly during the year, including at mandatory audit training courses.

We met with members of the Board and other senior partners and reviewed the firm's strategy, risk and quality plans and key communications relating to audit quality. We believe that the firm's strategy, communications and actions demonstrate the importance the firm attaches to achieving high quality audits.

2.2.2 Performance evaluation, promotions and remuneration

Performance evaluation

An annual performance evaluation is undertaken for all partners and staff. The appraisal is a self review process, supported by feedback from others. Every partner's appraisal includes an additional written commentary from the Head of Audit, referring to any AQR findings or external review findings. The direct involvement of the Head of Audit appeared to us to add significant value to the appraisal process.

Our review of appraisals covered a sample of appraisals completed in 2007 only. As a result, the director and manager appraisals were based on standard appraisal forms which have since been updated in line with prior year AIU recommendations. The firm's merit rating process for staff has recently been expanded to cover managers and directors (this process does not apply to partners).

Overall we found the assessment sections of the appraisal forms to be adequately completed, including consideration of the individual's contribution to audit quality. While the forms now clearly evidence consideration of performance in relation to quality in each appraisal, our review indicated that forward looking audit quality objectives were not being explicitly set.

Reference in appraisals to additional billings generated on audit clients

In some cases the appraisal documentation for partners included reference to additional billings generated on their own audit clients and, in the case of one director and one manager, objectives set included cross selling to their own audit clients. We note that additional objective setting guidance for partners for the 2007/08 appraisal process stated that sales targets for audit partners must exclude cross selling non audit services to his/her own audit client base. We believe that the firm should take further steps to ensure that partners and staff are not set objectives relating to cross selling to their own audit clients, and do not seek recognition of success in such cross selling by inclusion within their appraisal documentation of additional billings generated on their own audit clients.

Promotion and remuneration

There are separate processes for promotion to audit director and partner. We discussed the promotion process with the firm and reviewed the documentation for a sample of candidates for promotion to director and partner level.

While staff merit ratings will be one of a number of factors considered in setting remuneration, there is no directly observable link between the two. Partner remuneration was set in 2006 for the period under review, with the next bi-annual review due in the first half of 2008, and therefore we did not review the partner remuneration process during this visit.

2.2.3 Other human resource matters

Audit training

A full range of technical and personal skills training is provided by the firm, including a mandatory annual course, covering audit updates, changes to methodology and the findings of internal and external reviews.

Mandatory audit training is monitored centrally, while each office or sector group monitors attendance at industry training. Our review of the monitoring process noted that a number of partners and staff had not completed their mandatory training. Specific steps taken to mitigate any risk associated with non-attendance or any processes followed to ensure the individuals concerned were made aware of the content of the courses were not evidenced.

We reviewed certain training material for both mandatory and industry training and found the material to be satisfactory.

Credit crunch communications

We understand that issues arising from the credit crunch have been discussed regularly at partner meetings. A communication to all staff in January 2008 included specific reference to the potential impact on going concern audit work and other areas likely to be affected by the credit crunch. The annual Audit Update training course also included a session, led by the Business Restructuring Stream, on early warning signs and case studies on going concern risks. The communications appeared appropriate in relation to the firm's client base.

Audit partner licences

For certain categories of audit clients, including charities, pension schemes and certain specialist industry sectors such as financial services clients, partners require an internal licence to act as the audit engagement partner. Licences are issued based on the partner's knowledge and experience and may be removed if partners fail to remain up to date on technical matters in that field, including through attendance at relevant training courses. Attendance at relevant training is specifically monitored to ensure individuals remain up to date on developments in those areas. In our view, this licensing approach contributes to audit quality.

2.2.4 Client risk assessment and acceptance / continuance

Firms are required to have policies and procedures in place to provide them with assurance that client integrity, compliance with ethical requirements and their competence,

capabilities and resources are considered before they decide whether to accept or continue an audit engagement.⁸

The audit acceptance process includes completion of a standard form ensuring audit teams perform the necessary risk assessment, and consideration of independence and any conflicts of interest prior to accepting an audit appointment. Where “elevated risks” are identified, approval is required at a more senior level. For subsequent years, audit teams are required to complete an annual continuance form as part of audit planning.

We reviewed the firm’s acceptance and continuance policies and procedures and selected a sample of annual continuance forms for review.

While there are various processes in place to identify high risk clients and consider the need for additional safeguards in certain circumstances, there is no system to record the highest risk clients and provide a central management tool to ensure safeguards are implemented and monitored.

2.2.5 Consultation and review

Pre-issuance technical reviews

The firm requires that all audited financial statements of public interest entities, as identified by the firm, are subject to pre-issuance technical review by someone independent from the audit team.

For all listed entities, and the majority of non-listed public interest entities, the reviews are undertaken by a member of the technical department. For specialist non-listed public interest entities, such as charities, the review is performed by internally licensed partners.

Based on our review of individual audits, pre-issuance technical reviews are performed in accordance with policy.

Engagement Quality Control Review

Firms are required to have policies and procedures in place requiring an engagement quality control review to be undertaken for all audits of financial statements of listed entities and other audits meeting specified criteria.⁹

⁸ International Standard on Quality Control (UK and Ireland) 1, paragraph 28

⁹ International Standard on Quality Control (UK and Ireland) 1, paragraph 60.

The planning section of the audit files includes an assessment of whether the client is “Sensitive”, based predominantly on whether it is considered of public interest but taking account of certain other factors. All Sensitive clients require an Engagement Quality Control Review, performed by an independent partner (the EQCR). The firm’s policy is that only partners with at least 7 years experience at partner level are eligible to be EQCRs.

EQCR reviews for the individual audits we reviewed were generally well evidenced at the completion stage of the audit. Although the firm’s guidance is clear in requiring the involvement of the EQCR at the planning stage, this is only evidenced through a sign off at the end of the audit.

2.2.6 Audit quality monitoring

Annual audit quality monitoring

Firms are required to have monitoring procedures in place, including reviews of a selection of completed audit engagements, to provide them with assurance that their system of quality control is adequate, operating effectively and complied with in practice. Such monitoring is required to be undertaken at least annually.¹⁰

The 2007 audit quality monitoring (AQR) visits were conducted in October/November 2007 and covered 86 audits and 68 partners and directors authorised to sign audit reports across all offices. A positive development in the year was the decision to cover 60% of the partners and directors authorised to sign audit reports each year rather than 100% in order to enable reviewers to spend more time on each review.

Each review team is headed by an experienced audit partner, and includes at least one member of the central monitoring function. Where the files selected include a specialist client such as a charity, appropriate internal specialists are involved in the review. Independence of the reviewers is ensured through using a team from a different office and through the central function selecting the review teams and the files to be reviewed.

Instructions are issued to the reviewers in advance of the review setting out the objectives of the process, a checklist, appropriate guidance and reporting templates. A designated partner is responsible for monitoring and documenting the implementation of, and compliance with, any corrective actions. The firm does not use a formal grading system for individual audits reviewed but does prepare a report on each review setting out the findings arising and the reviewer’s conclusions.

¹⁰ International Standard on Quality Control (UK and Ireland) 1, paragraph 74 and the ICAEW’s Audit Regulations.

It is evident from our review that the firm has effective audit quality monitoring procedures. The firm's response to the issues identified, in terms of level of additional review and ultimately certain sanctions imposed, evidence the level of attention given to such findings and the importance placed on these by senior management.

While a checklist is provided as guidance to AQR reviewers, the reviewer is not required to complete and retain it. As a result, the only supporting evidence for the review completed is the outcome in terms of the issues identified rather than details of the work performed. In our view, evidence of the extent of the review undertaken, and in particular the work performed to assess whether auditing standard requirements have been met, should be retained.

Other audit quality monitoring processes

An annual review of compliance with regulatory requirements at a firm-wide level is performed and reported to the Management Executive.

In addition, periodic quality reviews of member firms are undertaken by BDO International. The UK firm was last reviewed in late 2007. This review is less detailed in nature than the UK firm's AQR.

2.3 Independence and ethics

2.3.1 Ethical policies and consultation

Firms are required to have policies and procedures in place designed to achieve compliance with the Ethical Standards issued by the Auditing Practices Board together with relevant ethical pronouncements issued by the professional body with which the firm is registered.

The firm's ethical policies and procedures relevant to the audit practice are set out in the firm's Audit Manual. They are based on, and have been mapped to, the requirements of the Ethical Standards. Guidance is issued through "Ethical Helpsheets". The firm intends to update its Helpsheets in 2008 to reflect the revised Ethical Standards and provide enhanced guidance based on practical experience.

We have reviewed the updates to policies and procedures and, based on our review, the firm has comprehensive ethical policies and procedures.

2.3.2 *Compliance monitoring procedures*

The firm requires all partners and staff to complete an annual declaration covering their personal independence, including financial interests.

In line with a prior year AIU recommendation, the 2007 process was performed using a new automated tool. A report to the firm's Management Executive in December 2007 highlighted significant matters arising and actions taken to resolve them. The report concluded that the new automated tool had been a success. There were no significant outstanding matters at that time.

2.3.3 *Rotation policies and monitoring*

Firms are required to have policies and procedures in place to monitor the length of service of partners and senior staff on individual audit engagements, assess any threats arising to auditor objectivity and implement appropriate safeguards. This reflects the need to avoid auditor independence being compromised by the familiarity threat arising from a long period of service in a senior role. For listed company audits, the engagement partner and engagement quality control reviewer are required to rotate after having served for a maximum period of five years and key audit partners (KAPs) are required to rotate after seven years.¹¹

The firm's rotation policies are consistent with ethical requirements. In addition, in 2007 the firm implemented revised rotation policies covering non-listed public interest entities, requiring the rotation of engagement partners after seven years.

Rotation monitoring is performed using excel spreadsheets which are updated regularly. The rotation of engagement partners, KAPs and EQCRs for listed and other public interest entities is monitored centrally. Engagement partner rotation for all other, non-listed, entities is monitored locally by the relevant office and reported to the Head of Audit as part of the annual portfolio review process.

We reviewed the rotation spreadsheets, documents submitted to the Head of Audit as part of the annual portfolio review process and, as part of our review of individual audits, the planning documents maintained by audit teams regarding the length of service of other partners and staff in senior positions.

The annual portfolio review identified certain entities where the partner had been involved for between 11 and 15 years. While discussion with the Head of Audit indicated that the

¹¹ APB Ethical Standard 3, paragraphs 5, 6, 12 and 16. "Key audit partners" are partners other than the audit engagement partner responsible for key audit decisions or judgments.

need for safeguards had been considered in each case, in most cases there was no documented evidence of specific safeguards or other actions being taken. In our view, consideration should be given to formalising this process to clearly evidence the conclusions reached and actions taken.

The monitoring of long association of other partners and staff in senior positions is performed by audit teams. Following a prior year AIU recommendation, changes were made to the standard planning templates to improve evidence of monitoring. Due to the year ends selected for our review, we have not seen this new process working in practice.

2.4 Audit performance

This section covers findings arising from our review of the firm's audit methodology and our review of individual audits. Our findings are set out under the following headings:

- 2.4.1 Audit methodology
- 2.4.2 Assessing and responding to risk
- 2.4.3 Audit evidence and related judgments
- 2.4.4 Communicating with Audit Committees
- 2.4.5 Audit finalisation

Any findings relating to quality control and independence are covered in sections 2.2 and 2.3 respectively.

2.4.1 *Audit methodology*

The firm's audit methodology is developed and maintained by BDO International. The UK firm is heavily involved in the development of the methodology, which has been tailored to reflect the additional requirements of UK standards.

The software tool allows most of the audit working papers to be stored electronically, although use is still made of paper files for some audit procedures, in particular partner and EQCR review. The audit teams also have access to a library of standard procedures, designed with reference to financial statement areas, and certain industry specific procedures.

One of the strengths of the audit software is its flexibility to record the audit team's assessment of risk and the proposed audit response. The audit team identifies an area of focus, assigns a risk categorisation and then links this risk to audit responses.

We reviewed the application of the firm's methodology on the audits selected for our review and comment on the findings below. In our view, the firm's audit methodology and systems are generally sufficient, if properly applied, to facilitate compliance with the requirements of auditing standards.

2.4.2 Assessing and responding to risk

Auditing Standards require the identification and assessment of the risks of the financial statements being materially misstated, including which of these risks require special audit consideration (such risks are termed "significant risks").¹² A proper assessment of the significance of identified risks is important to ensure that audit work planned and undertaken is sufficiently focused on higher risk areas of the audit.

We were pleased to note that, in response to an AIU recommendation in 2006/7, the firm had implemented certain enhancements to its standard audit documentation relating to the assessment of audit risk, including fraud risks. Nevertheless, our review of individual audits identified a number of findings in this area, in particular in relation to the identification of significant risks, the assessment of the design and implementation of controls over significant risks, and the evidencing of fraud risk considerations. In our view, further enhancements and guidance should be considered to assist audit teams to fully address the requirements of the relevant standards.

2.4.3 Audit evidence and related judgments

We were, subject to our comments below, generally satisfied with the audit evidence obtained for key financial statement areas reviewed and the basis on which significant audit judgments reviewed were exercised.

Completeness, existence and accuracy of stock

In two audits, both of which related to an entity in a sector where stock is significant, we considered that the audit strategy regarding the audit of completeness, existence and accuracy of stock was unclear and that, in certain respects, it was not clear from the audit files whether sufficient audit evidence had been obtained.

Analytical procedures

In three cases where analytical procedures were performed to obtain audit evidence, audit expectations and acceptance thresholds were not sufficiently established or justified.

¹² International Standard on Auditing (UK and Ireland) 315, paragraphs 100 and 108

2.4.4 *Communicating with Audit Committees*

Auditing Standards require the auditor to communicate matters of governance interest arising from the audit with those charged with governance of the entity. Such communications will usually take place with an Audit Committee or similar body acting on behalf of the Board.¹³ Appropriate communication with the Audit Committee or other relevant governance body contributes to the quality of the audit and assists both parties to discharge their responsibilities effectively.

The firm has prepared example documents for audit teams to refer to when preparing communications to audit committees. We believe these example documents provide clear guidance to audit teams, in accordance with the requirements of Auditing Standards. However, we identified a number of issues in this area, including a lack of evidence of required reporting and, in one case, insufficient consideration of to whom to report in the absence of an audit committee.

2.4.5 *Audit finalisation*

Audit finalisation procedures include a final analytical review of the financial statements as a whole, a review of events occurring after the end of the financial year that may require adjustment of, or disclosure in, the financial statements (“subsequent events”) and consideration of the appropriateness of the going concern assumption in preparing the financial statements.

In our view, the audit finalisation procedures were generally performed to a good standard.

8 December 2008

END OF REPORT

¹³ International Standard on Auditing (UK and Ireland) 260, paragraph 11

Appendix A – Firm’s response

The firm’s response is on the following page.

Strictly Private and Confidential

The Audit Inspection Unit
Aldwych House
71-91 Aldwych
London
WC2B 4HN

28 November 2008

Dear Sirs,

BDO Stoy Hayward LLP - Response to the Audit Inspection Unit's ("AIU") Public Report 2007/8

BDO Stoy Hayward LLP (BDO) is pleased to submit its response to the AIU's Public Report on the 2007/8 inspection of the firm. We have consistently advocated that public reporting by the AIU will provide greater transparency to the audit market, thereby helping meet the needs of stakeholders and building confidence in the profession. We welcome independent inspection of our audit process and we believe that the AIU's findings and observations assist us in achieving our shared objective of improving audit quality.

BDO is committed to the highest standards of audit quality. Indeed, winning the Accountancy Age 2008 Audit Team of the Year Award is a testament to the quality of our service. The report issued by the US Public Company Accounting Oversight Board in 2006, which raised no adverse findings, is further evidence of our focus on quality.

We continually monitor our policies and procedures for the Audit Practice to ensure that they meet the objectives of the Financial Reporting Council's Audit Quality Framework¹. We are pleased that the report acknowledges that the firm has actively implemented the prior year recommendations and, following the 2007/8 inspection, we have considered the findings and have already taken action to address them. In addition, we have discussed the findings relating to individual file reviews with the relevant Audit Committee or Board and have considered them fully during the subsequent audit.

It is pleasing to note that the report does not identify any issues with the audit opinions issued by the firm or with the extent of work performed by our audit teams. The AIU was generally satisfied with the audit evidence obtained and the basis on which significant audit judgements were exercised. Although the report notes that certain aspects of our work required significant improvement, principally regarding the audit of stock, the AIU

¹ The Audit Quality Framework dated February 2008 issued by the Financial Reporting Council. A copy is available from the FRC's website www.frc.org.uk



has confirmed to us that it was clear that significant audit effort had been directed towards this area. The findings related primarily to documentation and we acknowledge the specific improvements required although we would not regard the matters as being unduly significant.

We are pleased that the AIU has commented positively on our audit policies and procedures, including recognising the firm's commitment to ensuring audit quality, and judging the standard of procedures relating to quality control, independence and audit finalisation to be good. The AIU also concluded that the firm has effective audit quality monitoring procedures.

Going forward, in our view it is important that the AIU's reviews are undertaken on a consistent basis and we are committed to working with it to ensure that the processes and approach continue to be improved.

If you wish to discuss our response in further detail, please contact Tony Perkins, the Firm's Head of Audit.

Yours faithfully

BDO Stoy Hayward LLP.

BDO Stoy Hayward LLP

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