



AUDIT INSPECTION UNIT

PUBLIC REPORT ON THE 2008/9 INSPECTION OF HORWATH CLARK WHITEHILL LLP

5 NOVEMBER 2009

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 Horwath Clark Whitehill LLP (“HCW” 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 2009 (“the 2008/9 inspection”). Our inspection was primarily conducted in the period from January 2009 to April 2009 (referred to as “the time of our inspection”). This is the second year that the AIU has reported publicly on individual firms. However, this was our first full scope inspection of the firm and no previous public report has therefore been issued.

This report 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 HCW at least every two years¹. The 2008/9 inspection was the AIU’s first inspection of the firm. The ARC considers whether audit registration should be continued for the firm following each inspection undertaken. The AIU’s 2008/9 report to the ARC, which was finalised in September 2009, recommended that the firm’s registration to conduct audit work should be continued.

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 may therefore apply equally to other firms without having arisen in the course of the AIU’s inspection fieldwork at those other firms in the relevant year. Also, 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.

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

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.

have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed by the AIU within 12 months of its private report on the 2008/9 inspection being finalised.

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 HCW in the conduct of the 2008/9 inspection.

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.

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 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.

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 in our 2008/9 inspection. These related to unlisted major public interest entities with financial year ends between March 2008 and June 2008. Our reviews covered selected aspects of the audit only.

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

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.

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. HCW is the UK member firm of Crowe Horwath International (previously Horwath International), described as an 'integrated network of accounting and advisory services firms'. There is a separate, independent firm in Hartlepool that uses the Horwath Clark Whitehill name under a licence agreement from HCW. That firm does not carry out work within the AIU's scope and has, therefore, not been inspected by us.

The firm is organised into regional offices and business units including Audit, Business and Tax (ABT) within the London office. All statutory audit work is performed within the ABT business unit and regional offices

Partners and managers within ABT in the London office specialise in the corporate, not for profit, professional practices or pensions sectors. Within the regional offices, most of the partners and managers also specialise in one of the sectors referred to above.

For the year ended 30 September 2008, the firm's turnover was £45.6 million, of which £22.7 million related to statutory audit work. The average number of partners and staff in the year was 641⁴. There were a total of 70 partners, of whom 44 were authorised to sign audit reports, and one employee who was also authorised to sign audit reports⁵.

The firm had 17 audit clients within the scope of independent inspection by the AIU as at the 2008/9 reference date of 28 February 2008. These comprised one company with a full listing, one with an AIM listing, nine pension schemes, three charities, two large unlisted companies and a limited liability partnership.

1.4 Reporting on AIU reviews of individual audit engagements

The AIU introduced new reporting arrangements in respect of its reviews of individual audit engagements commencing from 2008, with the objective of increasing transparency

⁴ As disclosed in the annual return to the ICAEW as at 30 September 2008.

⁵ As disclosed in the annual return to the ICAEW as at 30 September 2008.

and meeting the increased expectations of stakeholders. This involved issuing new letter style reports on audits reviewed by the AIU. Although addressed to the relevant audit engagement partner or director, the Oversight Board expects firms to provide copies of these reports to the directors of the relevant clients.

2 Findings

2.1 Overview

Our review of the firm's strategy, plans and key communications demonstrated the importance the firm places on audit quality.

In our view, the firm generally has appropriate policies and procedures in place for its size and the nature of its client base in the relevant areas which are subject to our review. Of particular note was the formation of an Audit Operations Group in 2007 to review policies and procedures proactively as set out in section 2.4.1. In our view, the Group's activities are likely to make a positive contribution to audit quality. We identified certain areas for improvement, including some matters relating to performance evaluation procedures and the firm's annual quality review processes, as set out in sections 2.2 to 2.4 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. Where appropriate, we have commented on 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 procedures were 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, one of the audits we reviewed required significant improvements in certain areas. These areas included the adequacy of the audit evidence obtained in respect of a material transaction concluded shortly after the year-end and evidencing appropriate consideration of whether related disclosures should have been included in the financial statements.

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 are set out 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*

The day to day management of the firm is the responsibility of the National Executive Team, which is appointed by the Chief Executive and monitored by a Supervisory Board. A Management Board, which was set up in 2008, also reports to the Chief Executive.

We met the Chief Executive and other senior partners and reviewed the firm's strategy, plans and key communications relating to audit quality to assess the emphasis placed by the firm on audit quality.

The strategy for the audit practice is included within the firm's overall strategy. Whilst the partnership key performance indicators concentrate on financial targets, the core vision and values cited on the HCW website, intranet and corporate brochure included an emphasis on 'achievement of excellence'. These values are embedded into the core business plans and the implementation of the firm's values is also overseen by the Audit Operations Group, which reports jointly to the Chief Executive and the Head of Professional Standards.

Further, the bi-annual Chief Executive's report to the partners also highlighted the importance of audit quality and the review by the Audit Operations Group of the firm's methodology to improve audit quality and processes.

A statutory requirement for listed company auditors to publish annual transparency reports, under regulations made by the Oversight Board, took effect for financial years commencing after 6 April 2008. HCW is not legally required to publish a transparency report and has no current plans to do so on a voluntary basis.

2.2.2 Performance evaluation, promotions and remuneration

Audit partners and staff are appraised annually. The firm uses a contributions framework for the purposes of the development and appraisal of partners, whilst staff are graded against both competencies and specific objectives as set out in more detail below.

There is a separate process for the key stage of promotion to partner, which includes a report on the candidate to the Chief Executive. The Chief Executive also asks the firm's Senior Development Panel to interview and report on the candidate.

We reviewed the performance evaluation, promotion and remuneration procedures and noted that the firm has invested considerable effort and resource into these areas in recent years. We also reviewed a sample of partner and staff appraisals, a sample of partner and director promotion nomination files and remuneration models. We note below a number of areas for improvement relating to references in the appraisals of partners and staff to selling non-audit services to their audit clients, the guidance on what constitutes audit quality objectives and the linkage between appraisals and partner remuneration.

Partner contributions and staff objectives

The suggested contributions, behaviours and examples within the appraisal forms are the same for audit and non-audit partners. There was no guidance regarding parts of the appraisal form which would not be appropriate for audit partners under APB Ethical Standards. The partner performance appraisal criteria include two suggested contributions, supported by examples, which appear to involve rewarding partners for cross selling to their own audit clients contrary to the requirements of the APB Ethical Standards. In our view, this is inappropriate and needs to be changed.

Our review of appraisals identified that four partners and one member of staff had inappropriately referred to cross selling non-audit work to their audit clients in the year or inappropriately included objectives to cross sell on their own audit clients.

Consideration of audit quality in the appraisal process

We reviewed a sample of appraisals of audit partners and found that they had all been completed with appropriate emphasis on audit quality, with the exception of the appraisal of one audit partner. This partner had received the highest performance grade for audit quality, but this was inconsistent with the grading of one of his audits as 'not satisfactory' by the firm's Quality Assurance Review ('QAR').

The firm has not produced guidance as to what constitutes audit quality objectives. Our review of staff appraisal forms indicated that specific quality objectives were not always

clearly identifiable, with seven of the ten staff appraisals selected for review not explicitly considering audit quality in assessing performance and in setting objectives.

Linkage between audit quality and remuneration

We believe that the firm should improve the clarity of the linkage between quality related inputs, such as feedback from the firm's QAR and appraisal processes, and the remuneration process. In particular there was no explicit link between appraisals and partner remuneration.

2.2.3 Other human resource matters

Audit training and professional development

Regular communications, including technical bulletins and e-mails, are issued to cover matters such as the findings from the QAR review and technical developments. Once issued the technical material is retained on the intranet and the firm has processes in place to ensure that this information is updated at least annually, but in practice the processes enforce a review of technical information in a significantly shorter period.

We noted a regional initiative to monitor attendance at courses. However, there are no formal procedures in place to monitor attendance of partners and staff on mandatory training courses. Further, there are no procedures or guidance in place to ensure that non-attendees participate in appropriate alternative training sessions.

We met personnel from the training and technical departments and we reviewed certain audit training material and technical updates. We concluded that the firm has a comprehensive range of training courses covering, inter alia, audit methodology, accounting, ethics and specific business sectors such as not for profit bodies and pension schemes. These are supplemented by regionally co-ordinated external training courses.

Accreditation

HCW operates an accreditation system, whereby partners and staff are required to hold an HCW accreditation before acting as an engagement partner, Engagement Quality Control Reviewer (EQCR) or engagement manager on the audit of listed entities, not for profit bodies and pension schemes. Partners and staff obtain the accreditation through gaining relevant experience in the sector as well as attending the mandatory training courses.

The firm recognised that the monitoring process for accredited partners and staff was not taking place and we were informed that active monitoring of the accreditation system would recommence in the summer of 2009. The firm also advised us that it would be

reviewing the accreditation system to ascertain whether the training provided meets the specific needs identified from internal and external quality reviews. In our view, this would be a positive step.

Communications and other actions relating to the economic downturn

The sharing of information relating to the economic downturn within HCW's business units is generally informal due to the small number of partners in each unit, who are usually based in the same location. Our visit to a regional office also identified a regional response to the economic downturn, whereby the quality of the planning was reviewed for a number of audits.

The firm's guidance on going concern audit procedures and related standard documentation was revised and enhanced in early February 2009 after consideration of the guidance issued by the APB in December 2008.

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 engagement⁶.

The firm has in place specific procedures for the acceptance of new audits. The engagement partner is required to prepare a comprehensive paper, which includes the consideration of risks, for approval by an Acceptance Committee for those engagements that exceed a certain level of financial risk exposure. For certain audits, where potential recurring fees or the financial risk exposure is above a predetermined level, approval is also required from the Chief Executive.

Audit engagement teams have responsibility for considering continuance on an annual basis.

In the course of our file reviews we evaluated the continuance procedures adopted. We concluded that in all cases the engagement teams had followed the firm's methodology in assessing whether to continue with the engagement. However, there are no requirements in place to ensure that further consultation or approval is sought to continue to act as auditors of clients where the risk exposure has escalated since the original acceptance.

⁶ International Standard on Quality Control (UK and Ireland) 1, paragraph 28

2.2.5 *Consultation and review*

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 criteria⁷. The firm refers to such reviews as Engagement Quality Control Reviewer (EQCR) reviews and this terminology is used in this report.

The Audit Compliance Partner appoints the EQCR. They are required on all entities within AIU scope and certain other entities considered by the firm to be of public interest. As noted in section 2.2.3, an EQCR must hold the appropriate accreditation for the audit, which requires attendance at mandatory sector specific training courses. We reviewed the application of the EQCR review procedures as part of our review of individual audits and met selected EQCRs. We found that the involvement of the EQCR was adequately evidenced on those audits.

Pre-issuance technical reviews

The firm requires all financial statements for entities listed on the main market, AIM or PLUS markets to be subject to an independent technical review by the National Audit and Accounting Technical department prior to signing the relevant audit report. In our view, this is satisfactory but none of the audits we reviewed during this inspection were covered by this requirement.

2.2.6 *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 annually⁸.

The firm's Quality Assurance Review (QAR) programme is an annual national programme covering all UK offices. The QAR programme covers the quality of individual audits and comprises a review of a sample of engagements. Two grading systems are used for these reviews. The first provides a percentage score for the audit and for each of the sections reviewed in the audit. The second grading system, which was introduced in 2008, provides

⁷ International Standard on Quality Control (UK and Ireland) 1, paragraph 60.

⁸ International Standard on Quality Control (UK and Ireland) 1, paragraph 74 and the ICAEW's Audit Regulations.

an overall grade of either “Green - satisfactory”, “Amber - not satisfactory – of less concern than red” or “Red – not satisfactory – significant”.

The QAR is designed to cover every person authorised to sign audit reports of public interest clients annually and other persons authorised to sign audit reports at least every three years. In addition, the audits selected cover each person newly authorised to sign audit reports and any authorised person who failed to reach set percentages in the previous QAR.

The firm’s Practice Assurance Review is a separate process comprising an examination of the firm’s procedures at an office level.

We reviewed these processes, the 2008 results and the follow up actions noted by the firm. We concluded that the firm had invested significant resource and effort to develop and improve audit quality monitoring procedures and noted that the issues identified in the QAR process were described in detail in the office reports and reports to the Chief Executive.

One audit was reviewed by both the QAR and the AIU and the narrative findings of the QAR were broadly consistent with the findings identified by the AIU. However, the percentage scores given to individual audits were, in our view, consistently generous and did not reflect the nature of the findings noted. As a consequence, the scope for identifying both higher quality audits and areas for improvement was limited.

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 guidance are disseminated by the Ethics Partner or the National Audit and Accounting Technical department. The Ethics Partner has firm-wide responsibility for ensuring compliance with the firm’s policies and is the main point of contact within the firm in relation to ethical matters.

The firm had mapped the requirements of the Ethical Standards to its policies and procedures, but this mapping had not been updated to reflect the revised Ethical Standards issued in April 2008. Guidance had, however, been issued to all personnel that highlighted the main changes to the firm’s policies as a result of the revision of the Ethical Standards.

We reviewed the firm's ethical policies and found them to be generally comprehensive. However, as noted in section 2.2, the firm's policies did not prevent partners and staff from being rewarded for the selling of non-audit services to their own audit clients. There were also no procedures in place requiring business relationships with audit clients to be identified and monitored by the firm.

2.3.2 Compliance monitoring procedures

The firm performs an annual independence and fit and proper process which requires partners and staff to answer a series of questions on their personal independence. We reviewed the 2008 annual independence and fit and proper process and found that it was comprehensive and generally being complied with.

The firm has established an ethics database for partners and staff to record ethical queries for resolution by the Ethics Partner. We met the Ethics Partner and reviewed the ethics database and concluded that the matters raised were being dealt with on a timely basis.

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 EQCR are required to rotate after having served for a maximum period of five years and key partners are required to rotate after seven years⁹.

The firm centrally monitors the rotation of engagement partners, EQCRs, and engagement managers on those audit clients deemed by the firm to be of public interest. This includes all entities within the AIU scope and other entities considered by the firm to be in the 'public eye'. However, the firm had not extended the listed company rotation requirements to non-listed public interest audit clients.

For non-listed audit clients the firm's guidance states that when an audit partner or senior staff member has been involved with the audit for nine years, the audit team should contact the Ethics Partner detailing why the individual should continue to participate in the audit engagement, or confirming that rotation is to take place. We noted that a number of audit teams sought permission from the Ethics Partner for the extended involvement of a partner or senior team member without disclosing the precise length of time that

⁹ APB Ethical Standard 3 (Revised), paragraphs 5, 6, 12 and 18. "Key partners" are partners other than the audit engagement partner responsible for key audit decisions or judgments.

individual had been involved in the audit. In our view, this information should have been sought by the Ethics Partner when determining whether to approve the extension.

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 uses the Caseware computerised audit system which is based on Auditing Standard requirements and covers the entire audit process. Although Caseware is a proprietary software package, the audit methodology used within it is the firm's own and the firm has tailored the software accordingly. Supporting audit tools and guidance have been developed by the firm, with sector specific guidance also developed for the Not for Profit, Pensions and Professional Practice sectors.

In 2007 the firm set up an Audit Operations Group (AOG) with the objective to drive forward the HCW audit business and improve efficiency, whilst having appropriate regard to risk, ethical and compliance obligations and maintaining audit quality. The AOG jointly reports to the firm's Chief Executive and the Head of Professional Standards. The AOG's activities include reviewing audit methodology, technical changes, best practice, audit tools and Caseware; guidance to audit staff, education and training; and financial performance and management. In our view, its activities are likely to make a positive contribution to audit quality.

As part of our firm-wide work we reviewed the firm's mapping of the requirements of the Auditing Standards to its audit methodology. We believe that the firm's audit methodology and systems are generally sufficient to enable audit teams to comply with Auditing Standard requirements. However, we identified a number of specific areas where the methodology or its application requires improvement. These areas are set out below and in sections 2.4.2 to 2.4.5.

We noted that the firm's audit methodology and guidance did not cover considering the competence of other auditors whose work is to be used or performing procedures to obtain appropriate evidence that their work is adequate for group audit purposes.

We also noted that the firm's audit methodology did not include any guidance or procedures regarding the audit of opening balances or comparatives or consideration of information other than the audited financial statements contained in the Annual Report.

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")¹⁰. 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.

Evaluation of the design and implementation of controls

Auditing Standards require the auditor to evaluate the design and implementation of controls over significant risks. There were recurring issues arising in our file reviews regarding the evaluation of controls over significant risks. In three audits the key controls over significant risks were not identified separately from the controls in standard cycles. Further, where controls over significant risks were identified it was unclear whether the design of those controls had been assessed.

We believe that the audit systems do not easily facilitate the evaluation of the design and implementation of controls over significant risks. In our view, this issue would be reduced if the firm's system had a way of recording and concluding on the evaluation of the design and implementation of controls over significant risks.

2.4.3 Audit evidence and related judgments

We were, subject to our comments below, generally satisfied with the basis on which significant audit judgments were exercised on the five individual audits reviewed.

Analytical procedures

In three audits we reviewed we found deficiencies in the analytical procedures used to obtain audit evidence, including the setting of the difference between recorded amounts and expected values that was acceptable without further investigation. As a result, in one

¹⁰ International Standard on Auditing (UK and Ireland) 315, paragraphs 100 and 108

of these audits there was no substantive audit evidence obtained over investment income which was a material amount in the financial statements.

Direct assistance from internal audit staff

On one audit we reviewed, internal audit staff provided direct assistance to the external audit team. The assistance provided included undertaking external audit procedures in an area of the financial statements identified as giving rise to a significant risk of material misstatement and involved judgment in assessing whether a matter should be brought to the attention of the external audit team. In our view, the basis on which the work of internal audit staff was used was inappropriate.

Discussion of issues raised in the internal audit staff reports was evidenced in the audit working papers. However, the underlying working papers were not included on the external audit file and there was no evidence of review of these working papers by the external auditors. In our view, the extent of supervision and evidencing of the work of internal audit staff was inadequate.

Related parties

In two audits we reviewed, where related parties were in our view significant, we concluded that the identification and consideration of related party transactions was inadequate. Further, in one of these audits there was, in our view, insufficient audit evidence obtained to support the conclusion that there was no controlling party.

In our view, the extent of these issues would be reduced if the firm's audit systems had a better way of ensuring that adequate consideration is given to the existence of related and controlling parties.

Audit of journals

In three audits we reviewed we considered that there was inadequate evidence on file relating to the audit of journals. In two audits, the audit of journals posted in the year was inadequately evidenced and on the third audit the relevant detailed working papers to support the conclusions reached had been mislaid.

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 Board¹¹. 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.

We found that reporting to Audit Committees in respect of the audits reviewed was generally of a satisfactory standard and communications were made on a timely basis.

However, in one audit reviewed by us there had been a serious breakdown in client controls that resulted in an unaudited set of accounts with an electronically scanned auditor's signature being filed without the knowledge of the audit team. These accounts were subsequently withdrawn and resubmitted on completion of the audit. We were informed that this matter was reported orally to the chair of the Audit Committee after the audit report was issued. In our view, however, this breakdown of controls should have been reported in writing to the Audit Committee before signing the audit report.

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.

Generally we found that such procedures had been performed to an acceptable standard, subject to our comments below.

Subsequent events

On one audit a material transaction was completed post year-end but prior to the approval of the accounts. There was no evidence on the audit file that an agreement relating to the transaction had been obtained and reviewed to consider whether the accounts should include either an accrual for, or disclosure of, this significant transaction.

Going Concern

In two audits, although going concern was not considered to be an area of high audit risk, there was, in our view, insufficient evidence on the audit file supporting the assessment of going concern. In one of these audits there was no evaluation of the assessment made by the Board of the group's ability to continue as a going concern.

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

Auditor's Statement about Contributions

The auditor of a pension scheme is required to report in the Auditor's Statement about Contributions whether contributions have been paid materially at least in accordance with the Schedule of Contributions. The audit team concluded that a late payment was not material to the Auditor's Statement about Contributions. In our view, in reaching their conclusion the team should have taken account of the amount of the late payment as well as the length of the delay.

5 November 2009

END OF REPORT

Appendix A – Firm’s response

The firm’s response is on the following page

27 October 2009

Audit Inspection Unit
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Dear Sirs

PUBLIC REPORT ON THE 2008/9 INSPECTION OF HORWATH CLARK WHITEHILL LLP

Thank you for the opportunity to comment on the Public Report on the 2008/9 Inspection of this firm.

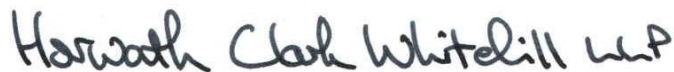
Audit quality is important to us and we take it very seriously. We seek to embed, in all aspects of our business, a range of values, which embrace quality. Examples of these values are trust, integrity and honesty, quality service, the achievement of excellence against a background of professionalism and independence, and the continuous development of our people.

This inspection was the first full scope visit from the AIU and as such included its first review of our 'whole of firm' procedures. We are pleased, therefore, that the AIU concluded that generally the firm has appropriate policies and procedures in place given our size and the nature of our client base in the relevant areas subject to the AIU's review.

A number of the matters identified by the AIU and included in the public report were also identified by ourselves in the course of our own quality assurance reviews. Any necessary changes to our procedures and our methodology have been either undertaken and completed, or put in hand.

We would like to express our appreciation to the AIU for the constructive manner in which they conducted the Inspection.

Yours faithfully



Horwath Clark Whitehill LLP



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