



**PROFESSIONAL OVERSIGHT BOARD**

**REPORTING ON AUDIT QUALITY MONITORING –  
IMPLEMENTING A NEW APPROACH**

**RESULTS OF CONSULTATION AND POLICY CONCLUSIONS**

**4TH DECEMBER 2007**



## Contents

		<i>Page</i>
<b>One</b>	<b>Background to the Consultation</b>	<b>2</b>
<hr/>		
<b>Two</b>	<b>Results of Consultation and Policy Conclusions</b>	<b>3</b>
<hr/>		
<b>Annex 1</b>	<b>Respondents to Consultation Document</b>	<b>17</b>
<hr/>		

## One – Background to the Consultation

### Introduction

- 1.1 The Professional Oversight Board (Oversight Board) is the body within the UK's Financial Reporting Council (FRC) which has the overall responsibility for audit regulation in the UK. It is also responsible, through the Audit Inspection Unit (AIU), for monitoring directly the quality of the auditing of economically significant entities.

### Background

- 1.2 In the last year two years there has been heightened interest in the form and content of public reporting by the AIU of its monitoring of the quality of audit work at the major UK audit firms. In particular there have been calls for the AIU to publish, in whole or in part, its private reports on findings at individual audit firms and/or make relevant information available privately to audit committees.
- 1.3 The Oversight Board consulted on this issue in June 2006. However subsequent to that consultation legislation was passed which will bring the Oversight Board, including the AIU, within the scope of the Freedom of Information Act 2000 (FOIA) with effect from 6th April 2008. Consequently the Oversight Board undertook further informal consultation with a range of key stakeholders before making firm proposals for change. A clear consensus emerged that greater transparency as to the findings of the AIU's work was needed, primarily to meet increased expectations on the part of stakeholders, and that the current reporting arrangements were therefore no longer appropriate.
- 1.4 In June 2007 the Oversight Board published a second Consultation entitled: "Reporting on Audit Quality Monitoring - Implementing a New Approach". That Consultation set out a reporting model for the AIU which, in the Oversight Board's considered view, would achieve the maximum level of transparency consistent with maintaining the effectiveness of the inspection process.
- 1.5 The proposed revised reporting model for the AIU set out in the June 2007 Consultation took account of the views expressed in the extensive formal and informal consultations, in particular with the audit firms affected, which took place over the previous year. Accordingly, the June 2007 Consultation focused on issues relating to the implementation of the proposed new reporting model.
- 1.6 The Oversight Board has now considered the responses received and reached policy conclusions on the matters consulted on, which are set out in this paper.

## Two – Results of Consultation and Policy Conclusions

### Number of respondents

2.1 Eighteen non-confidential responses to the Consultation were received and are published on the FRC website. Table 1 shows respondents by the type of stakeholder

Audit Firms	7
Public Companies	5
UK Professional Bodies	3
International Body (IFAC)	1
Other	2
Total	18

A list of the respondents is set out in Annex 1.

The Oversight Board is grateful to all respondents for their time and effort in responding to the Consultation.

2.2 The Consultation document sought views on the following matters:

- The appropriateness of the processes the AIU intended to follow before the new high-level reports on audit firms and individual audits are finalised.
- The proposed form of future annual reporting on generic themes and issues identified by the AIU.
- The Oversight Board's provisional regulatory impact assessment

2.3 While the Consultation was primarily on issues relating to the implementation of the proposed new reporting model, some respondents took the opportunity to comment more widely on the reporting model itself.

2.4 Respondents raised a wide variety of issues, and it is not practicable to comment on them all in this paper. We have commented on responses either where they were frequently expressed or where the Oversight Board considers they raised important issues, but have not commented on issues which were outside the scope of this Consultation,

### Overview of Responses

2.5 All the public companies which responded supported the new approach to public reporting and were of the view that the processes proposed to be adopted are appropriate.

2.6 The audit firm respondents and their professional bodies expressed reservations, particularly concerning reporting on individual audits, but some were fully or broadly supportive of the overall proposals.

2.7 The principal areas of concern for respondents were as follows:

- Having two or three publication dates per year for the publication of the new high-level reports on the audit firms;
- Publishing a list of the entities whose audit has been reviewed;
- The level of safeguards in place to prevent wider distribution of the new high-level reports on individual audits if they are provided by auditors to their clients;
- That AIU reports would be requested by third parties using the Freedom of Information Act; and
- That the new high-level reports both on the audit firm and on individual audits should include the audit firm's own comments.

The Oversight Board recognises the concern expressed by some respondents and has made changes to its proposals in response. Those changes along with further details of the issues raised by respondents are set out in the sections which follow.

2.8 Extracts from responses have been quoted throughout this paper. Some extracts have been selected because they are representative of comments made by a range of respondents, and others have been selected in order to illustrate a particular point but are not necessarily representative of a widely held point of view.

## **Responses to each Consultation Question**

2.9 The Consultation document posed the following specific questions:

### **Question 1**

**Are the processes we intend to follow before high-level reports on individual firms are published appropriate?**

### **Question 2**

**Are the processes we intend to follow before new style reports on individual audits are finalised appropriate?**

### **Question 3**

**Do you have any comments on the Board's proposal that annual reporting on the AIU's work should in future be incorporated in the Oversight Board's annual report to the Secretary of State for Trade and Industry (now Business, Enterprise and Regulatory Reform) ?**

#### **Question 4**

**Do you have any comments on the Board’s provisional regulatory impact assessment?**

The following analysis summarises the responses received and the issues raised by the respondents along with the Oversight Board’s response.

#### **Question 1**

**Are the processes we intend to follow before high-level reports on individual firms are published appropriate?**

2.10 While most of the respondents support the processes the AIU intends to follow before high-level reports on individual firms are published, many of them raise concerns about the Oversight Board’s suggestion of setting two or three publication dates each year.

#### **PricewaterhouseCoopers LLP**

We consider that the proposal to publish annual firm specific reports on either two or three publication dates is likely to give an unfair competitive advantage or disadvantage to firms with an earlier reporting cycle. We maintain that the current AIU annual reporting system (one publication date) will remove any unfairness solely dependent upon timing but also provide the clarity of one publication date for users of this information.

#### **BDO Stoy Hayward LLP**

Our preference would be to publish all the reports at once, or if impractical, in blocks of reports such that the AIU would only report twice a year maximum. We suggest that a detailed timetable is developed in consultation with the firms.

2.11 Some of the respondents noted the practical problems that would be caused by publishing all the reports at once.

#### **Institute of Chartered Accountants in England and Wales**

Our preference would be to publish all the reports at once but we appreciate the practical problems that this would cause. The consultation document mentions that two or three publication dates would be established in advance. In addition we suggest that a detailed timetable is developed in consultation with the firms and the ARC so that there is a greater chance that the publication dates can be met.

#### **Deloitte & Touche LLP**

We note the intention to publish completed reports on two or three dates throughout the year. Whilst this may be appropriate on an on-going basis, we would suggest that for the first year, reporting is planned so that as many high-level firm reports as possible, and certainly reports on all those firms subject to full scope inspection visits, are available. This will help avoid undue attention being paid to any single firm or small number of firms whose reports are the first to be released.

- 2.12 The Consultation referred to audit firms being given an opportunity to provide written comments on a draft of their report before publication. Respondents support the idea of firms providing comments on the high-level reports before publication, however they were unclear whether the firms' comments would be included in the reports and some respondents specifically commented that they should be.

**The Association of International Accountants**

The AIA also supports the AIU's provision for firms to provide written comments on a draft of their high-level report before it is published. The AIA believes this will be beneficial in maintaining the current constructive dialogue that exists between the Board and the firms subject to inspection.

**Deloitte & Touche LLP**

We support the intention to allow firms to provide written comment on the high-level reports before finalisation. It is not clear whether the POB intends that these comments would be published with the high-level report, but we strongly believe that this would be appropriate.

- 2.13 The Consultation made it clear that the high-level report on each firm would not be published in advance of consideration by the relevant Audit Registration Committee of the detailed private report on the firm. Both the ICAEW and the ICAS were of the view that their Audit Registration Committees should be given an opportunity to review the high-level reports before publication.
- 2.14 The Professional bodies also commented that they may take regulatory or disciplinary action as a result of the detailed AIU report and in this regard the publication of high-level reports by the AIU should not be implemented in a way which impacts on their ability to undertake such action. It was similarly commented by others that identification of such disciplinary investigations would be unfair to the firm or individual subject to such an investigation.
- 2.15 Many respondents commented on the need to maintain confidentiality, and the issues this raises for many aspects of the proposals set out in the Consultation document, particularly that it should not be possible to identify clients or individuals within the firm.
- 2.16 Respondents commented on the need for AIU reports to be balanced and to include some recognition of the quality of audit work undertaken. Such responses will have been influenced by the style and content of the private reports currently prepared for the Audit Registration Committee of the relevant professional body.

**Ernst & Young LLP**

Reporting must include some recognition of the quality that is delivered as well as material failures to do so. Fair reporting would take on an audit opinion style, including proper background and context to promote public understanding of the issues raised by AIU inspections.

- 2.17 Some respondents expressed concern regarding the framework for reporting and called for "*Audit Standards*" for regulatory reviews to be developed.

2.18 Similarly the lack of an accepted definition of audit quality and the absence of a framework to measure and compare it objectively was referred to. There was an acknowledgement that the FRC project and discussion paper “*Promoting Audit Quality*” was a valuable contribution.

### **Oversight Board Comment and Policy Conclusion concerning issues raised in connection with Question 1**

2.19 The Oversight Board is conscious of the concerns raised by respondents.

2.20 As regards the issue of the timing of publication of the high-level reports on individual firms, it is appreciated that the publication of these reports, especially in the first year will attract attention and this should not be focussed on just one or two firms. Conversely it is impractical for the AIU to undertake its inspection work at all firms on a parallel and simultaneous basis and consequently, if only one publication date a year is adopted the reports for some firms will be significantly out of date.

2.21 The Oversight Board have concluded that in the first year(2007/8) all reports for firms where a full scope AIU inspection has been undertaken will be published on the same date, which is expected to be autumn 2008. In subsequent years there will be two publication dates a year. Not all firms subject to AIU full scope inspections receive an annual inspection visit; consequently reports will not be issued for all such firms every year.

2.22 Regarding the inclusion of comments in the report, it was the intention of the Oversight Board that audit firms should be asked to provide written comments on a draft of the high-level report. The purpose of requesting such written comments on the high-level report is to ensure that any factual inaccuracies or inappropriate summarisation are identified and to enable the AIU to take the firm’s comments into account in the final drafting of the report. As such it will not be appropriate to include such comments in the final published report.

2.23 However, there is merit in providing an opportunity for the firms to comment formally within the report and the Oversight Board have concluded that firms should be invited to submit a letter of comment which will be included as an Appendix to the AIU report.

2.24 The high-level reports on individual firms will be based on the more detailed private reports prepared for the Audit Registration Committees of the professional bodies. It is therefore not the intention to add a further stage into the process and share such reports with the Audit Registration Committees before publication.

2.25 The Oversight Board acknowledges the concerns raised regarding confidentiality, both as regards the public reports on each audit firm and the new style reports on individual audits. Those concerns are responded to at length under Question 2 below. However, so far as the public reports on audit firms are concerned, the AIU confirms that it will ensure, as far as practicable, that clients and individuals within the firm are not identifiable from the public reports.

- 2.26 The Oversight Board intends that the high-level reports will not contain the same level of detail as the current private reports to the Audit Registration Committees, and will provide appropriate context to the findings.
- 2.27 The Oversight Board believes that the FRC project and discussion paper “*Promoting Audit Quality*” which now includes an identification of the “*Drivers of Audit Quality*” has contributed significantly to the debate in this area. Future AIU inspection cycles will have regard to those Drivers of Audit Quality.
- 2.28 Through the International Forum of Independent Audit Regulators and the European Group of Auditor Oversight Bodies, the Oversight Board and the AIU are contributing to groups which are working on developing frameworks and policies for audit inspection.

## Question 2

**Are the processes we intend to follow before new style reports on individual audits are finalised appropriate?**

### Part A

*Issues in connection with publication of a list of audits reviewed and confidentiality of reports on individual audits if they are provided by auditors to their clients.*

- 2.29 The audit firm and professional body respondents raised a range of concerns in connection with the proposed lifting of the restriction on firms discussing the results of the AIU reviews with their clients, the new-style reports on audits reviewed, and the publication of the list of audits reviewed. From the tenor of the comments received it would appear that, whilst auditors are accepting of the need for more transparent reporting in principle, they are more sensitive about reporting on specific audits.
- 2.30 Some respondents, particularly those from Public Companies, welcome the increased transparency which lifting the restriction preventing firms discussing reports with their clients will bring.

#### **Aviva plc**

We consider that there will undoubtedly be benefit to Audit Committees in having sight of the individual reports pertaining to their audit, in particular with meeting the requirements of the Combined Code to assess the effectiveness of the auditors.

- 2.31 The proposal to publish a list of the audits reviewed was commented on unfavourably by five of the seven audit firms responding and all three of the professional bodies responding.
- 2.32 These respondents were concerned that the publication of a list of audits reviewed will lead to speculation which attempts to link comments in the high-level report on the firm with particular audits and that this risk will be particularly acute where the firm has few clients reviewed or few clients in a particular sector. Respondents believed this could potentially be damaging both to the audit client and the audit firm.

2.33 Similarly respondents believed that the publication of a list would lead to requests under the Freedom of Information Act targeted at obtaining more details of the AIU findings.

**Grant Thornton UK LLP**

We have significant concerns around the proposal to publish a list of assignments that have been reviewed by the AIU. It is not evident how the AIU will guard against publishing information in firm reports that allows a third party to guess, or possibly incorrectly infer, which comments relates to which assignments.

**PricewaterhouseCoopers LLP**

The inevitable effect of publishing this list will be to create a ‘feeding frenzy’ for companies and the regulator to disclose the contents of the AIU private reports with the result that those reports will enter the public domain.

2.34 Whilst PKF did not comment on the publication of a list of audits, KPMG supported the proposal.

**KPMG LLP**

The publication of the annual list of audits reviewed by the AIU we regard as a logical extension of transparency and confidence.

2.35 It is also noticeable that none of the five public companies which responded made any comments on this aspect of the proposals.

2.36 Many of the audit firm respondents, and those from the professional bodies, were concerned that lifting the existing restriction on firms discussing the AIU findings with their clients, and encouraging firms to share the new-style reports in confidence with their clients, would run the risk that such reports will not remain confidential. Respondents consider this a particular risk because:

- Non-executive directors usually sit on more than one board resulting in a spread of knowledge beyond the original audited company.
- There will be interest in the AIU report and demand for copies from other parties such as investors, rating agencies, parties conducting due diligence etc.; and
- Such interest would be fuelled if the AIU were to publish a list of audit assignments reviewed.

2.37 Respondents generally questioned if any safeguards would be in place to prevent the wider distribution of such reports.

2.38 If such reports were not to remain confidential, respondents comment that this could cause unnecessary concern as to the quality of clients’ financial statements as well as the ability of the audit firm concerned.

**Institute of Chartered Accountants in England and Wales**

Our second point relates to the confidentiality of the report once it is in the possession of the audit client. While we have no wish to impugn the integrity of the audit client's directors, there are no proposals in the consultation document for maintaining the confidentiality of the report once released to the client. We believe that it is essential that the importance of maintaining confidentiality is stressed in the report on the client and that they are made aware of the legal obligations for maintaining confidentiality.

**Ernst & Young LLP**

Our main issue with individual audit reports is one of lost confidentiality..... If disclosed, individual audit reports will have the potential to harm companies needlessly through no fault of their own. Once a private individual audit report has been issued, it may be years before the relevant company's audit is reviewed again. This is not a satisfactory position for the company and, in the event of an unfavourable report, it will require comfort about its auditors within a short time frame.

2.39 Many respondents raised wider concerns regarding the application of the Freedom of Information Act to the Oversight Board and the possibility that applicants under that Act could obtain reports and information not intended for publication.

2.40 Some respondents drew attention to the Draft Regulations implementing the requirements of the Statutory Audit Directive which impose statutory confidentiality requirements on the AIU. Those Regulations, once finalised, will amend the Companies Act 2006 with effect from 6<sup>th</sup> April 2008. The Oversight Board has been working closely with the Department of Business, Enterprise and Regulatory Reform in the development of those Draft Regulations so as to provide the maximum degree of protection of confidentiality consistent with the proposed more transparent form of reporting by the AIU.

**Oversight Board Comment and Policy Conclusion concerning Question 2 Part A**

*Issues in connection with publication of a list of audits reviewed and confidentiality of reports on individual audits if they are provided by auditors to their clients.*

2.41 The Oversight Board is conscious of the serious concerns that many respondents have raised regarding maintaining confidentiality of private reports on individual audits. The Oversight Board believes that maintenance of confidentiality is in the interests of clients, their directors and the auditors. They note that auditors routinely report in writing to clients on the outcome of their audit and such information does not find its way into the public domain and the provision of such information is not prejudicial to the companies concerned.

2.42 The new high-level private reports on individual audits will be provided to the audit firm on the basis that those reports are kept confidential and not disclosed to any third party, with the exception of the client concerned. As an extension to this it will be made clear that discussing the results of the AIU inspection with the client, or providing the client with the

high-level report, is to be undertaken by the audit firm on the basis that the client accepts that the information or report so provided is to be treated as confidential and is not to be provided to any third party.

- 2.43 The Freedom of Information Act will apply to the Oversight Board with effect from 6<sup>th</sup> April 2008 from which date it must act in accordance therewith. The Draft Regulations referred to above, introducing new statutory confidentiality requirements, will have the effect of imposing a statutory confidentiality obligation on the AIU and on recipients of AIU reports. The Oversight Board expects firms to make this clear to their clients.
- 2.44 The statutory confidentiality requirements will be effective from 6<sup>th</sup> April 2008. In order to align the new reporting with the introduction of the statutory confidentiality requirement, one element of the proposal to adopt the new reporting regime will now be delayed as detailed in section 2.51.
- 2.45 As regards the publication of a list of audits subject to review by the AIU, the Oversight Board does not now intend to publish such a list.

## **Question 2**

**Are the processes we intend to follow before new style reports on individual audits are finalised appropriate?**

### **Part B**

*Issues in connection with the content of the new-style reports on individual audits and the timing of the change in reporting format.*

- 2.46 Respondents from the audit profession expressed widespread concern about the possible content of the new-style high-level private report on the conduct of individual audits, and particularly that such reports should be balanced and not focus only on the negatives.

#### **KPMG LLP**

The challenge is for the reports to do justice to the full overall picture of the audit work that has been carried out - not just focus on any negatives. It is just as important to focus on what has been done well as what has not been done so well.

#### **London Society of Chartered Accountants**

There is little in the consultation to help understand exactly what will go into the published reports, other than to say that the "main findings" will be included. It is important for any reader to obtain a balanced, fair and comparable picture of audit quality. This ought to mean that both positives and negatives are included and not just adverse findings. It will also be important that "main findings" are determined in a way that makes comparisons between firms and between audits possible in a way that is fair.

Driven by similar concerns, some respondents wanted a classification of the issues raised to include an assessment of materiality or seriousness of the particular matter. Ernst & Young commented that such a classification would need to be clearer than those currently used. Some respondents considered that the new-style reports on individual audits should include a response from the firm. This issue was linked to the concern that these new-style private reports would not remain confidential.

**Ernst & Young LLP**

The individual audit report should also include the firm's response, rather than the firm having to make a separate public statement. This will avoid the position being played out in the press in the event that one of these reports was ever disclosed outside the audited company.

2.47 Some respondents suggested that a further period of consultation should be undertaken or that the proposed changes should be delayed, and that the reporting changes should not be applied to audit reviews which had commenced prior to the publication of this report.

**Oversight Board Comment and Policy Conclusion concerning Question 2 Part B**

*Issues in connection with the content of the new-style reports on individual audits and the timing of the change in reporting format.*

2.48 Clearly the new reporting regime cannot be successful if the content of the reports is not fit for purpose. The Oversight Board accepts that issues raised in the new-style private reports need to be put in an appropriate context and intends that the reports will refer to positive features where appropriate. However, the primary focus of an inspection is to identify areas for improvement rather than areas of strength. This will necessarily be reflected in the content of the reports. To do otherwise would involve significantly more time being incurred as the whole focus of the file review would change, and as much time would be spent in debating possible strengths with the AIU as is now spent in debate about the relevance of apparent weaknesses.

2.49 It is the intention that the new-style high-level reports highlight only the more significant findings identified during the course of the file review rather than summarising all the findings. It is therefore not necessary to grade those findings as to their seriousness. Such findings may relate to the appropriateness of the processes adopted by the auditors in the context of the requirements of auditing standards, for example in regard to audit planning or the identification of significant risks.

2.50 As set out in the Consultation document, the existing arrangements for documenting the detailed issues arising from file reviews, discussing and sharing them with the audit teams and obtaining their responses will continue. The audit firm has adequate opportunity during this process to make the AIU aware of its view on all the issues raised, and the new-style report will be based on this earlier stage. The firm will have an opportunity to provide written comments on the new-style reports before they are formally issued by the AIU to the

firm. The firm can provide any comments it wishes to make when meeting with their client to discuss the AIU report, or when forwarding the report to their client. Some firms have commented that they intend to keep their clients informed of progress on the file reviews as they progress so that the content of the final report does not come as a surprise. It is for the firm itself to advise its clients as to any action taken or proposed by it to address matters raised in a report. The Oversight Board does not consider it necessary or appropriate to provide the audit firm with a further platform to comment on matters raised by the AIU and therefore firms' comments will not be included in the AIU's final reports on individual audits.

2.51 The Oversight Board has decided that further consultation is not required. However, the new-style reporting on individual audits will not now be applied to file reviews commencing prior to 31<sup>st</sup> December 2007, and no such reports will be issued until after 6<sup>th</sup> April 2008. This will have the following benefits:

- It will provide greater certainty as to the reporting outcome for reviews currently underway;
- It will provide an opportunity for the AIU to share with firms examples of the new style reports based on reviews actually carried out in the second half of 2007; and
- The timing will ensure that no new-style reports are issued before the new statutory confidentiality provisions apply.

As to the restriction on firms disclosing the fact that an AIU review has taken place or discussing the results of that review with their clients, the Oversight Board does not believe this any longer serves a useful purpose. On the publication of this paper, and as previously indicated to firms, they will therefore be free to discuss such matters with their clients. However, as no formal reports in the new style have been issued by the AIU, the previous style detailed private reports should not be provided to clients.

2.52 Some audit firms have separately expressed concern regarding how 'follow-up' reviews would be treated for this purpose. The AIU normally select a small number of audits for a 'follow-up' review to assess how the audit team addressed points raised in the previous year's inspection. In the first year of the new reporting regime, it would be impracticable to produce a new-style high-level report without repeating detail from the previous year's inspection. Consequently the Oversight Board has decided that new-style reports on follow-up reviews will only be prepared where the original file review commenced after 31<sup>st</sup> December 2007.

### Question 3

**Do you have any comments on the Board’s proposal that annual reporting on the AIU’s work should in future be incorporated in the Oversight Board’s annual report to the Secretary of State for Business, Enterprise and Regulatory Reform?**

2.53 A majority of the respondents did not object to the idea of dropping the AIU Annual Report and including an expanded section on the findings and overall results of AIU’s work in the Oversight Board’s annual report to the Secretary of State for Business, Enterprise and Regulatory Reform.

2.54 However, respondents also commented that the Annual Report provides a high profile commentary on themes and areas of challenge for the profession as well as an overall summary of quality within the audit profession. They believed that interest in this type of generic information will remain even after firm specific reports start to be published. Furthermore such information should provide a useful context to the reports on individual firms. Taking this further, a minority of respondents considered that the existing Annual Public Report should be continued.

#### **Institute of Chartered Accountants of Scotland**

The current AIU annual report provides useful generic information that shows the trends and issues in the auditing of public interest entities and listed companies. This information is vital if individual firm reports are published so that readers can place the individual report in context. We support the publication of a generic report, although we do not have strong views about where the information is published as long as it is still collated, analysed and made available. Our preference, however, would be to retain it as a separate report.

#### **Oversight Board Comment and Policy Conclusion concerning Question 3**

2.55 The Oversight Board thanks respondents for their views on this aspect of the AIU future reporting. It is clear that the AIU Annual Report is valued by many respondents. However there are limited resources, and, with more reporting at the firm level together with an overall summary in the Oversight Board’s report to the Secretary of State, it does not seem necessary to continue with a separate full AIU Annual Report. Consequently, the AIU will not continue with the current form of Annual Report.

2.56 In addition however, the AIU intends to publish annually a short overview at the same time as the reports on individual firms are published.

#### Question 4

##### Do you have any comments on the Board's provisional regulatory impact assessment?

- 2.57 Respondents considered that it was difficult to estimate the costs of the changes before the implementation of the new approach. The majority of respondents either did not comment on this aspect of the Consultation or did not express a view as to whether the estimated costs were too high or too low.
- 2.58 Of those who did express a clear view on the Oversight Board's estimate of costs, three considered them to be too low and two considered them to be too high.
- 2.59 As regards the benefits to be derived from these reporting changes, a number of the audit firms and professional bodies questioned whether there were sufficient likely benefits to justify the changes.

##### **Institute of Chartered Accountants in England and Wales**

The consultation document, as is the case with many regulatory impact assessments, assumes that benefits will arise but has difficulty in listing/quantifying what these would be. In our view there are considerable risks in the proposed approach which could result in unwarranted action taken by a company, or the market, based on a misunderstanding of an AIU report.

- 2.60 Some Public Company respondents specifically stated that in their view the benefits would outweigh the cost.
- 2.61 The danger of firms becoming more defensive in dealing with the AIU and the overall impact of this on the process was commented on by some respondents.

##### **London Society of Chartered Accountants**

We also remain concerned, as we set out in our response to the previous consultation paper on this topic, that, knowing that the criticism will be published, audit firms will argue the point and resist rather than accepting the criticism and taking steps to improve their procedures. The AIU may also be inhibited from making any criticism unless they feel that they have a watertight case. The net result may well be prolonged expensive legalistic disagreements, rather than incremental improvements in the standards of auditing.

- 2.62 Some respondents commented on the need for an agreed overall timetable, adherence to which would not only ensure that audit inspections are completed efficiently and effectively but also that the AIU were in a position to publish reports on agreed dates.

##### **Oversight Board Comment and Policy Conclusion concerning Question 4**

- 2.63 The Oversight Board believes that the costs outlined in the Consultation document are a reasonable estimate of the likely additional costs to be incurred, but is conscious of the need to control costs and limit any increase. For example the number of audits reviewed during

the initial years affected by these changes (2007/8 and 2008/9) is planned to be lower than the number reviewed in the preceding period.

- 2.64 The Oversight Board recognises that the prospective benefits to be achieved through greater transparency are not easily quantified and accepts that the Consultation document did not attempt to do so in any detail. However respondents are reminded that changes in the reporting regime are themselves a response to the high profile campaign calling for more information to be made available on audit quality, especially for the benefit of company directors. That campaign resulted, twelve months ago, in an amendment to the Companies Bill such that the Freedom of Information Act would be applied to the AIU. It is also clear from the responses to the Consultation that respondents from the public company sector welcome the greater transparency that will be provided.
- 2.65 The AIU has already seen evidence of a greater degree of challenge after the Consultation was announced, with some delays in responding to points raised during inspection field work.
- 2.66 The Oversight Board intends to agree timetables with individual firms which, if met, will ensure that reports on individual firms can be published on one or two dates a year as set out in paragraph 2.21 above.

## Annex 1

### LIST OF RESPONDENTS

Admiral Group Plc  
The Association of International Accountants (AIA)  
Aviva plc  
BDO Stoy Hayward LLP  
BG Group plc  
Deloitte & Touche LLP  
Ernst & Young LLP  
Grant Thornton UK LLP  
International Auditing and Assurance Standards Board (IAASB)  
Institute of Chartered Accountants in England and Wales (ICAEW)  
Institute of Chartered Accountants in Scotland (ICAS)  
KPMG LLP  
London Society of Chartered Accountants (LSCA)  
PKF (UK) LLP  
PricewaterhouseCoopers LLP (PwC)  
Scottish & Newcastle plc  
The British Land Company PLC  
Wales Audit Office