



THE INSTITUTE  
OF CHARTERED  
ACCOUNTANTS  
IN ENGLAND AND WALES

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Our ref: AAF Rep

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Dear Jon

### **FRC DISCUSSION PAPER: PROMOTING AUDIT QUALITY**

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the Discussion Paper *Promoting Audit Quality* published by the Financial Reporting Council (the 'FRC') in November 2006.

The issue of this discussion paper and the interest of the FRC in audit quality is important. The FRC has a significant role to play in promoting sound audit principles and appropriate regulation that will assist in building market confidence in the value and quality of audit opinions. Also, given the importance of decisions on audit matters that are now made internationally, there is a specific need for the FRC and its operating bodies to be active on the international stage in pressing for measured regulation and in emphasising the critical importance of professional judgement and principles-based standards.

The Institute has had a significant interest in these issues for some time, as evidenced by its publication of *Audit Quality* in 2002 and subsequent activities. We are keen to work with the FRC on these issues and to continue to play a leading role in promoting audit quality through our various activities, including in our role as convenor of the Audit Quality Forum (see [www.icaew.com/auditquality](http://www.icaew.com/auditquality) for more information). We note that this discussion paper is described as the first in a series and it would be helpful for the FRC to clarify its future plans on the matters raised in this paper as part of future discussions between us.

We consider that there is much in the paper which is good and we are pleased that for the most part a balanced view is given. However, we do have some significant concerns and our main comments in this letter can be summarised as follows:

- Care is needed to avoid inadvertently giving the wrong message that audit quality is a significant problem, when there is not the evidence to support this.
- It is important to consider the possible impact of any proposed measures on audits as a whole and generally to take a 'bottom-up' approach with extra measures (if necessary) being imposed for audits of public interest entities (PIEs).
- There is merit in a broad view of what audit quality means when addressing the issues covered in the paper, rather than just focusing on 'market quality' as defined below.

- It is vital for the audit profession to continue to appear attractive in order to recruit and retain people of the right calibre and skills.
- Regulatory overload and complex and lengthy standards can be detrimental to the achievement of audit quality in the long term, and we call on the FRC and the APB to assess the impact of recent changes before further changes are proposed.
- The FRC and responsible parties in the UK have a crucial role to play in shaping international developments, in particular making the case for principles-based standards and the use of professional judgement.
- Appropriate education and training are fundamental to the success of the audit profession. The paper's concerns over existing professional training are in our view unsubstantiated.
- Concerns over the pyramid structure in firms are in our view overstated. Specifically, the use of the term 'inexperienced' is inappropriate in this context.

We expand on these concerns below. We also give our answers to the consultation questions in Appendix 1 to this letter.

### *1. Care is needed to avoid inadvertently giving the wrong message about audit quality*

The FRC's initiative needs to be handled very carefully so as not to give negative messages inadvertently. Audit quality is not an absolute; auditors provide reasonable rather than absolute assurance because society accepts that audit is subject to a cost-benefit equation. The FRC can play a helpful role in informing and, if necessary, educating audit stakeholders and society about what audit quality means and the drivers of quality, but there is a danger that the initiative might be perceived as being undertaken to address a major systemic problem. Although it is healthy to have an informed debate and a dialogue with investors and others about whether quality is satisfactory and how to improve audit quality (as is happening in the Audit Quality Forum), we consider it important to keep matters in perspective. For example, we are not aware of stakeholders having fundamental concerns with the current arrangements based on the findings of our most recent investor confidence survey. With respect to the reference in paragraph 1.19 to an "increasing climate of distrust", footnote 9 gives evidence of investor requests for more transparency but does not in fact indicate an increased level of distrust.

There is also a risk of any problem that is highlighted being viewed solely as an 'audit problem' when it might be more to do with wider corporate governance or financial reporting issues affecting others in addition to the auditor, e.g. ensuring disclosure of appropriate information by companies. We suggest that the FRC examines these issues in the context of the entire corporate governance and financial reporting process. For example, there might be external and internal pressures on directors, such as those arising from market expectations, to adopt short-term policies in their financial reporting and to avoid full transparency in their public reports. Other pressures include those arising from performance related pay and tighter reporting deadlines. Tackling issues from the audit perspective is only one part, albeit an important part, of a much bigger process.

### *2. Scope of the paper and the need for a 'bottom-up' approach*

The paper states that the FRC's initial focus is on the audits of UK listed companies and other PIEs. However, many of the issues covered are also relevant to all audits and we consider it very important to consider up-front the possible impact of any proposed measures on audits as a whole, including smaller entity audits. A 'bottom-up' approach would often be the most appropriate way of tackling these issues, for example having a base for all audits with extra measures being imposed for audits of PIEs, rather than the 'top-down' approach resulting from considering PIE audits first with special 'exemptions' for smaller entity audits being added later. There is also a need to consider application to the public sector.

### 3. Definition and drivers of audit quality

We note the commentary in chapter 2 regarding attempts to define ‘audit quality’ and its drivers. We consider that this is a fair analysis but it doesn’t in our view give a wholly balanced picture of all the barriers to achieving audit quality. Dealing with all the significant barriers, including inappropriate regulation and weaknesses in the financial reporting supply chain, is of fundamental importance to audit quality. We emphasise a number of concerns regarding these barriers in this letter.

In defining audit quality we consider that there is merit in a broad view, as we suggested last year in discussion with FRC and APB representatives. We consider all the following elements to be relevant:

- *Market quality*, i.e. quality in the eyes of principal external stakeholders. In the case of shareholders as a class this arises from the stewardship role, but there are also other external stakeholders who might use information for decisions. This element of quality should aim to satisfy the public interest in the audit.
- *Service quality*, i.e. quality in the eyes of client management and those charged with governance.
- *Operational quality*, i.e. from the firms’ perspective in order that the provision of audit services is sustainable.
- *Compliance quality*, i.e. quality in the eyes of regulators notwithstanding regulators’ clear interest in market quality and the interest that they should arguably also have in service and operational quality.

What drives audit quality and how to improve it if there are concerns, we suggest will depend on which of these four perspectives is adopted. The FRC’s definition and drivers tend to focus on market quality and we would hope the FRC ensures it obtains a fair balance of perspectives from individuals and organisations within stakeholder groups.

The perspectives above take account of the priorities of different stakeholders and can be used to judge how particular issues, such as those raised in the discussion paper, impact on the quality of the audit. For example, inappropriate training can be detrimental to service quality, the make-up of audit teams is relevant to operational quality and the approach of regulators has an impact on what is needed to achieve compliance quality.

With respect to what is said in paragraph 2.18 of the paper on the main drivers, the fourth bullet (audit reporting) is in our view determined by law and regulation. It is therefore not subjective in the way that is implied in chapter 2. Considering possible changes to the audit report is part of a debate on transparency but we consider that it is not a driver of quality. We believe that the Audit Quality Forum’s recently published report on audit reporting will be an important contribution to this debate. An extra key driver we would include is the company’s processes and behaviour, including the role of its audit committee (see comments under chapter 7). More work and guidance could be helpful on what the audit committee could report publicly.

We agree that the culture within the firm is of fundamental importance to achieving audit quality. A quality orientated culture should become institutionalised and this should be helped by the recent introduction of ISQC (UK and Ireland) 1. This standard now provides a benchmark against which firms’ operations can be assessed.

#### *4. Attractiveness of the profession*

A key part of audit quality is for the profession to appear attractive in order to recruit and retain the right people with the right skills. We welcome the FRC's recognition of this in its Regulatory Strategy, i.e. for audit to provide "a rewarding career thus attracting, developing and retaining high quality entrants for the long term stability of the profession". We consider that there is now a serious issue regarding the recruitment and particularly the retention of the right people, i.e. people who are not simply intelligent but who are also intellectually curious and persistent, challenging and with presence and personality. Whilst the profession continues to attract high quality graduates, the attractiveness of the profession appears to be declining as evidenced by decreasing job satisfaction, brought about at least in part by increased regulation. Remaining in the profession post-qualification is becoming a less attractive option partly as a result of the amount of compliance-type work carried out during the training contract. Unless the best people see audit as an interesting, profitable and safe environment they will not join it and no amount of "tone from the top", training and information infrastructure will overcome that fundamental weakness. We recognise that professional bodies and firms have a role to play through ensuring that only the right calibre of people enter the profession. In their activities for members and through their requirements the professional bodies can also play a key role in shaping the qualities and behaviours expected of members.

#### *5. Impact of regulation and increasingly complex and lengthy standards*

We consider that having an overly complex financial reporting regime can have a detrimental impact on audit quality as it can mean that partners and senior staff spend too much time on accounting issues or in preparing documentation for the benefit of regulators. We understand that this has been an increasing problem for firms. We would agree with the second bullet of paragraph 1.13 about accounting as the complexity and level of disclosures has limited the amount of time given in recent times to pure auditing. The emphasis given by regulators to accounts compliance, particularly note disclosure, has resulted in undue attention to items that might previously have been seen as immaterial in auditing terms. The focus ought to be on whether the accounts taken as a whole show a true and fair view rather than the minutiae of note disclosures. This situation might be exacerbated by the new offences for auditors in the Companies Act as auditors could give undue attention to detailed compliance issues given their fear of the consequences of errors.

As implied in the paper, there is a need to ensure that the more traditional skills of experienced auditors are properly valued and utilised. The complexity and length of recently issued accounting, auditing and ethical standards has distanced some experienced audit partners who now need to rely more on technical support. Consequently, some experienced auditors might have been lost to the profession to the detriment of audit quality. This is likely to have been made worse by the five year partner rotation requirement as referred to in our answer to consultation question 9. There is also the issue that greater complexity increases the need for specialists when putting together competent audit teams as required by ISQC (UK and Ireland) 1. We believe that the FRC needs to consider whether there are any competition and choice implications arising from this, i.e. whether there are difficulties for certain firms in accessing the requisite specialist skills and knowledge necessary to carry out audits at the more complex end of the market.

We therefore agree with the FRC considering issues regarding the complexity and length of recently introduced standards and support FRC efforts to ensure there are workable standards of manageable length.

Paragraph 1.13 could be read as being critical of the recently introduced risk-based approach to auditing. We supported the risk-based approach which is now enshrined in international auditing standards, as did the APB in promoting the UK-led risk model. We are still awaiting clear evidence

regarding the operation of the new ISAs (UK and Ireland) but informal feedback to date has generally been positive about the benefits of the risk-based approach.

Regulatory overload and compliance with rules can have a significantly detrimental impact on audit quality in various ways. We note the comments about computerised methodologies in chapter 5 of the paper. However, we understand that one of the main reasons for the introduction of automated systems is to assist with regulatory compliance. We consider that computerised methodologies are not bad in themselves, but we recognise there may be issues arising from their implementation and operation. We consider that there is more that could be said about computerisation than is currently in the paper and in particular there is a need to be more balanced regarding computerised methodologies as there are positive things to say about them with respect to both the effectiveness and the efficiency of audits. The key point is that the trend towards a 'box-ticking' approach (as described in the first bullet of paragraph 5.18) is driven mainly by the increasing number of requirements in standards rather than by computerisation. There might be a range of reasons why audit staff spend too much time in front of their computers, including the many requirements to document work for review purposes.

We agree with paragraph 1.10 that there has been a substantial amount of regulatory change in recent times. In our view it is very important to give time for these changes to bed in and the impact of the changes needs to be addressed before further changes are proposed. There needs to be a comprehensive regulatory impact assessment of recent regulatory changes, with a particular focus on smaller entity audits. The letter of 8 March 2007 from Martyn Jones, as Chair of the Institute's ISA implementation sub-group, to Richard Fleck regarding ISA implementation states the need for a moratorium after the Clarity Project is completed.

Regulatory overload of listed companies might be self-defeating as it could lead to the transfer of capital to higher risk and more opaque investment vehicles, such as hedge funds and private equity.

Paragraph 2.8 supports the regulator assessing the quality of audits and we are in favour of this. As it goes through the early stages of its learning curve, the AIU might put too much emphasis on compliance and finding examples of non-compliance rather than in assessing audit quality. We therefore consider that the AIU's focus and charter should be reviewed to reflect the spirit of paragraph 2.8 as it evolves. Part of this review could be to assess the outcome of referrals to the FRRP and whether audit quality has actually improved as a result of these.

The regulators do also have a constructive role to play in providing assurances to the market on audit quality where this is merited. Regulators therefore need to be balanced in their published regulatory assessments and give positive messages in these where appropriate.

## *6. Importance of the international dimension*

The international debate is crucial given the adoption of international standards and other international developments including the implementation of the EU Statutory Audit Directive. The FRC and its operating bodies have a crucial role to play in shaping these developments, for example in liaising with the European Commission and other regulators, and in making the case for the importance of principles-based standards and the use of professional judgement. More work might be needed on the nature of professional judgement which is distrusted by some non-UK regulators but which we believe is crucial to high quality audit work, and therefore needs to be better understood internationally. There is otherwise a real risk that audit quality in the UK will be threatened by the trans-national impact of measures agreed by regulators elsewhere, for example a tendency towards simplistic rules-based regulation that might be deemed appropriate in less mature markets. There is also a particular need for continued dialogue with US regulators given the worldwide impact of US regulatory policy.

With regard to auditing standards, footnote 21 on page 36 states that the APB is 'hopeful' that the standards coming out of the IAASB's Clarity Project will not be unduly prescriptive. This is something we hope for too but it might not be so easy to achieve. The APB should therefore take every opportunity it can to impress on the IAASB the need for present tense statements becoming requirements to fulfil the proportionality criteria, and for explanations to be given of why present tense statements become requirements, and not simply explanations of why they do not. In any case, standards that are 'objectives-oriented' might be quite different to principles-based standards and whatever term is used, the important issue is whether or not the standards have the right level of detail to guide auditor behaviour and judgement without creating a box-ticking mentality. These matters are considered in the Audit Quality Forum publication *Principles-based auditing standards*.

In reviewing auditing standards, it should be recognised that they were largely developed in a manufacturing era and have arguably not kept pace with the development of an information economy. The responsible parties therefore need to address these areas in the UK in order to lead the debate at the IAASB by drawing on the widespread experience of UK auditors and professional bodies.

There is a need for the UK to maintain its regulatory competitiveness. This might be lost as a result of benchmarking UK regulation to that of other countries. There is also a need to recognise that auditing standards could result in greatly increased business costs and in fewer initial public offerings.

## *7. Education and training*

We agree with the FRC that appropriate education and training are fundamental to the success of the audit profession. However, Chapter 4 of the paper – in particular paragraph 4.6 – is of concern to the Institute as we consider that it is incomplete regarding everything that is already happening with the modern ACA qualification.

The ACA is subject to a process of continuous improvement. The qualification and the syllabuses for the examinations are constantly reviewed and monitored. There is an annual syllabus review to ensure that the exams are always focussed on the needs of the current environment. In 2005, the Institute undertook a major review of the ACA and canvassed many stakeholders, including a variety of different size audit firms, technical experts, examiners and tutors. This was to ensure that the new ACA in 2007 was focussed on the needs of the stakeholders. Various stakeholder needs were identified and among these were:

- ensuring students have core technical skills;
- that employers can still attract high calibre people; and
- that the qualification has broad content with technical rigour.

Information regarding how the Institute has addressed these needs in the ACA for 2007 is given in Appendix 2 to this letter.

Against the backdrop of this action by the Institute, the paper surprisingly claims that:

- the final examination/qualification is less focussed on audit than it used to be;
- there is no longer a pure audit paper in the final exam;
- additional technical and practical training is required by the firms but there are shortcomings to this; and
- CPD does not necessarily cover the technical skills needed to support auditing.

The Institute believes that auditing does not exist in a vacuum and that audit and financial reporting are so closely related that it does not make sense to examine them apart. Nor can any weight be attached to a syllabus simply because there either is or is not a paper called “Advanced Auditing”. Auditing requires knowledge but demands a high level of judgement and other skills that are best developed and assessed in context.

The Institute’s Advanced Stage *does* have audit in it (as demonstrated by the overview in Appendix 2 and by the syllabus, learning materials and examinations themselves) but it takes it to a much higher level of commerciality and practicality than a traditional examination, especially through the Advanced Case Study. It is important for trainees to have an appreciation of commerciality and business in order to understand what is needed for effective auditing, e.g. auditing fair values and impairment reviews. The Case Study was introduced in 1994 and we believe has, as intended, helped to produce better auditors by placing technical audit matters in a business context. The core technical elements of auditing and assurance have already been addressed by students at the Professional Stage by the time they get to the Advanced Stage. Students are also constrained by Institute regulation (in line with past agreement with the DTI and IFAC requirement) from attempting the Advanced Case Study until they are in the final (typically third) year of training. This positions the ACA substantially beyond the level of some other recognised audit qualifications. Furthermore, the major auditing firms are extremely enthusiastic supporters of the ACA and its Advanced Case Study approach and we would refute any suggestion that deficiencies in the qualification require audit firms to increase the time they spend training students.

In our view the comment in 4.8 does not give proper credit to the Institute’s work-based learning and structured training in ethics programmes that develop learning and skill progression outside the classroom. Equally, the comment in paragraph 4.10 on CPD does not give proper credit to the Institute’s CPD requirements, in that technical requirements are a central part of compliance but it is also necessary for technical knowledge to be placed in a wider business and inter-personal context.

More generally, throughout the paper there seems to be an undervaluing of several other key components of the ACA and perhaps of the other recognised qualifications. Examples that could be mentioned include:

- the way in which the ACA majors on developing attributes of professional judgement and scepticism;
- the fact that at 48 weeks the Institute requires more work experience in audit for the Audit Qualification than any other recognised professional body;
- that the new ACA is examined in IFRS and this will substantially contribute to audit students’ understanding and competence in this new framework;
- that the ACA is about a fusion between knowledge, skills, attributes and work experience; and
- that our “Qualified Person Responsible for Training” and Counsellor system within authorised training organisations helps to develop the mentoring that the FRC desires.

As stated in our answer to consultation question 6, whilst we would not agree with the need for a fundamental review of the education and training of auditors, we would welcome discussion with the FRC, the POB and the APB regarding the comments made in the paper and the comments we have made above on the Institute’s qualification and training requirements.

It also needs to be emphasised that the firms have been able to attract high quality graduates from a wide range of subjects from top universities. This top talent is a major factor underpinning the regulation of high quality audit in the UK. In our view this must not be lost by making the audit qualification less business relevant.

## *8. Make-up of audit teams*

We are unclear regarding whether any specific actions might be proposed by the FRC in connection with the 'pyramid structure' which is described in paragraph 4.5 and we are doubtful whether any proposals that may be made regarding this would be realistic in practice. The whole point of a profession is to provide a service with a strong public interest element, through taking educated people and developing their theoretical and practical knowledge and skills further through continuous professional education, development and experience. It is inevitable and indeed desirable that in any leading recognised profession that there will be many people on the bottom rungs of the ladder. Instead, the word 'inexperienced' is used three times in chapter 4 to describe junior staff (in the summary and in paragraphs 4.5 and 4.21). We consider that the use of this term conveys the wrong message because although these people are less experienced than their senior colleagues (as would be expected as they build their skills), the firms devote substantial resources to the front-end training for those involved in audit work.

We are not aware of any inherent problem with this structure in firms achieving audit quality and consider that the key point is that firms ensure that junior staff assigned to particular audits are competent to do what is asked of them. In a team environment it is the collective knowledge and experience of the team that counts, with appropriate working practices to compensate for any relative inexperience that may exist. We are not aware of any evidence to back up the implied concerns in the paper about the 'pyramid structure' expressed in paragraph 4.5. In our view paragraph 4.21 correctly recognises the important point here regarding the need for staff to be properly directed and supervised and for firms to take the necessary measures to ensure this happens. We believe that the new ISAs (UK and Ireland) have helped in ensuring the active involvement of everyone in the audit team in the audit planning process and so the main issue should be whether firms are complying with these standards. There is a need for effective engagement management by firms, e.g. of how resources are deployed and of how review procedures operate.

We would welcome discussion with the FRC and the APB regarding the comments in the paper regarding the pyramid structure and our comments above.

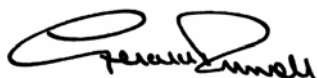
## *9. Next steps*

It would be helpful for the FRC and the APB to clarify the next steps envisaged on the matters raised in the paper. For example, will there be any particular new focus for AIU inspections and is appropriate research planned on certain issues? In our view any evidence gathered from these activities needs to arise from audits carried out using ISAs (UK and Ireland) and ISQC (UK and Ireland) 1 as some of the issues identified might already have been tackled by the recent introduction of these standards. The Institute considers it to be very important for the new standards to be allowed to bed in and to wait until there is sufficient experience of ISQC (UK and Ireland) 1 implementation and ISA (UK and Ireland) audits to assess the impact of these standards.



Please contact me or Chris Cantwell at the ICAEW Audit and Assurance Faculty (details as below) should you wish to discuss any of the points raised in this response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Gerald Russell'.

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## **APPENDIX 1: ANSWERS TO THE CONSULTATION QUESTIONS IN THE DISCUSSION PAPER**

### ***Chapter 3: The culture within an audit firm***

*Q1 Are there other important indicators of an audit firm's culture that are not referred to above?*

There needs to be good technical support throughout the firm. The culture of leadership is very important and should be emphasised.

*Q2 Are there pressures that could compromise the culture of audit firms that have not been identified above?*

An over-emphasis on compliance with rules at the expense of addressing other important aspects of quality, is a threat to audit quality (see our comments on regulation in section 5 of our letter).

*Q3 Are there any further steps that should be taken to build confidence in the culture of audit firms and, if so, what might they be and why are they needed?*

Not at this stage as ISQC (UK and Ireland) 1 is new. The impact this is having on firms will need to be assessed over time and we therefore suggest that the FRC plans a review of the implementation of this standard at the appropriate time.

Greater involvement by the audit committee can support the auditor prioritising quality (see comments on chapter 7 below).

### ***Chapter 4: The skills and personal qualities of audit partners and staff***

*Q4 Do you agree that technical skills, personal qualities and practical experience are key drivers of audit quality?*

Yes – see our substantial comments regarding this in section 7 of our letter. This is why the ACA and the Institute's Audit Qualification are built around these skills, qualities and experience.

*Q5 Has this paper identified the issues that could result in an inadequately trained or skilled workforce for audit – if not, what other issues are there and why are they issues?*

See our comments on make-up of audit teams in section 8 of our letter. We agree that this paper has identified some valid criteria but we do not agree with the inferences that these are "issues" and that the current audit workforce lacks this training and skills or that the Institute's Audit Qualification falls short in respect of the same.

*Q6 Should there be a fundamental review of the qualification and training requirements for auditors?*

Whilst we would welcome discussion with the FRC, the POB and the APB regarding the comments made in the paper on the education and training of auditors, we would not agree with the need for a fundamental review. The POB is already conducting a review of the professional bodies' practical training requirements for auditors as part of its remit. Time should be given to wait for the results of this review and the implementation of any recommendations arising from it before further consideration of a "fundamental review" should be considered. In addition, the Institute and the other RQBs are already subject to a comprehensive oversight process from the FRC and the POB which, amongst things, includes annual review visits, an annual audit return, 6-monthly statistical reports, and special in-depth projects examining the quality of particular aspects of the qualification. There is also an obligation to meet IFAC's *International Education Standards for Professional Accountants* (IES 1-7) and *Competence Requirements for Audit Professionals* (IES 8) – requirements which the Institute helped to shape in design and regularly exceeds in operation.

## **Chapter 5: The effectiveness of the audit process**

*Q7 Are there other factors that determine whether an audit process is effective?*

See our comments in section 4 of our letter regarding the attractiveness of the profession and in section 5 regarding the impact of regulation on the effectiveness of firms' processes.

A publicly reported company failure can have an impact on the trust (or lack of it) in the effectiveness of the audit process and so communication from the regulator regarding the facts of the case is important.

Our comments in section 2 of our letter highlight the need generally to take a 'bottom-up' approach to determining measures to improve audit effectiveness with extra measures (if necessary) being imposed for audits of PIEs.

*Q8 Are there threats to the effectiveness of the audit process that have not been identified above?*  
The dominant client (including chief executive) is a threat which does not seem to be covered here.

*Q9 Are there further steps that could be taken to counter the threats to the effectiveness of the audit process?*

See our earlier comments, for example in sections 5 and 6 of our letter. The impact of partner rotation should be considered in the light of relevant research, e.g. that already available from FEE. We consider that the rules could create difficulties in practice and this issue should be built into the review of the APB's Ethical Standards given the new seven year requirement in the Statutory Audit Directive.

The role of the audit committee (see chapter 7 comments below) could be mentioned here.

## **Chapter 6: The reliability and usefulness of audit reporting**

*Q10 Are there other factors that determine whether audit opinions command confidence?*

The reputation of a firm, and the individual partners in that firm, might be perceived as providing confidence.

*Q11 Are there other reasons why users may not have confidence in the audit opinion?*

This might be the case if users do not understand the report or if problems at a company are learned about through media other than the report itself.

*Q12 Are there further steps that could be taken to reinforce confidence in an audit opinion? In particular, what changes to the form and content of the audit report should be considered?*

See the Audit Quality Forum's recently published report on audit reporting.

## **Chapter 7: Factors outside the control of auditors affecting audit quality**

*Q13 Are there other external factors that have the potential to adversely affect audit quality?*

We consider that there is merit in taking a broad view of what audit quality means when addressing the issues covered in the paper, rather than just focusing on 'market quality'. See our comments regarding this in section 3 of our letter.

Also, as outlined in section 1 of our letter, we suggest that the FRC examines audit quality in the context of the entire corporate governance and financial reporting process.

As explained in section 5 of our letter, we consider that the approach of regulators is of critical importance to audit quality.

The impact of international factors is also crucial and these are covered in our comments in section 6 of our letter.

Other possible factors include: dominant chief executive (mentioned in answer to Q8 above), questionable attitude and integrity of the client, inability to deal with illness of key people at the client, and tight deadlines. The issue of time pressures is of critical importance, particularly given the introduction of new standards.

*Q14 Are audit committees discharging their responsibilities in relation to audit adequately, and if not, what further steps might be taken to make their role more effective?*

Much depends on the current and relevant experience of the audit committee members and the staff and expertise made available to them. There is sometimes uncertainty about how far the audit committee's responsibilities extend, e.g. do they cover risk management? We would welcome further exploration of the issues around the responsibilities of audit committees. The Audit Quality Forum's new *Evolution* series includes as one of its themes the *Impact of Audit Committees on Auditing*. We expect that this will develop thinking in this area and generate suggestions regarding the role of audit committees.

*Q15 Should the FRC develop more detailed guidance for audit committees in relation to the evaluation of audit effectiveness?*

This could be reviewed in the light of the Audit Quality Forum's forthcoming work on audit committees (see above). Regarding the comment in paragraph 7.6 about possible publication of a summary of the work undertaken by the audit committee to evaluate audit effectiveness, we would like clarification regarding what requests there have been for this. There is already a good deal of material available (including that from the Institute) and if anything new is issued, it would be important to emphasise the need for a two-way process between the auditors and the audit committee.

FRC support for training of audit committees would be helpful.

*Q16 Should annual reports include a summary of the work undertaken by the audit committee to evaluate audit effectiveness?*

Summaries of the work of the audit committee in annual reports might be helpful and this already happens in some sectors.

*Q17 Are there further steps that should be taken to reduce the risk that these external factors may adversely affect the audit process?*

The audit process needs to be seen as part of the broader corporate governance and financial reporting framework. Any actions taken by the FRC should be in the context of that broader framework as is noted in section 1 of our letter.

## **APPENDIX 2: THE NEW ACA AS AN AUDIT QUALIFICATION**

As stated in the main letter, various stakeholder needs for the ACA were identified in the 2005 review and among these were:

- ensuring students have core technical skills;
- that employers can still attract high calibre people; and
- that the qualification has broad content with technical rigour.

To address these needs, some of the changes to the ACA for 2007 are:

- examination papers increased in number from nine to fifteen;
- all the syllabuses reviewed in detail to ensure that students have a clear, definite progression through the qualification both technically and in their acquisition of professional skills;
- the first six papers ensure that students have a wide awareness of the key topics as early in their careers as possible, e.g. tax, accounting, assurance, etc;
- the next six papers then take these concepts and develop them further into a more technically rigorous examination, which also tests the students' ability to apply the topic, so ensuring that they know the technical content and how it actually operates and what it means.

The Advanced Stage has been made more technical in nature but otherwise remains predominantly unchanged as stakeholders agreed that this level was what set ICAEW Chartered Accountants apart from other accountants. This level consists of two examinations that have the main technical topics integrated in a commercial scenario. The capstone is an Advanced Case Study which can examine any topic from any of the ACA syllabuses in a complex manner, using a highly realistic commercial situation, and in so doing it assesses whether students have the intellectual qualities outlined in section 4 of our letter.

Looking at Audit and Assurance specifically, it appears in the following papers in the new ACA:

1. Assurance – 1.5 hour electronic examination.
2. Audit and Assurance – 2.5 hour written application examination.
3. Business Reporting – 3.5 hour integrated examination of which 25-35% of the paper will be on audit and assurance.
4. Business Change – 3.5 hour integrated exam of which 15-20% of the paper will be on assurance.
5. Case Study – 4 hour written examination with a minimum of two days pre-reading and research in which the students have to spot where to bring in audit and assurance.

This progression of audit and assurance throughout the 2007 ACA qualification gives students the skills required for the current environment:

- The first two examinations ensure that the students have the required technical knowledge and that it can be applied to audit scenarios.
- The next two examinations examine audit and assurance in an integrated fashion in its natural environment – that being financial reporting and business analysis. Indeed, to examine a full understanding of the implications of audit, it could be argued that it needs to be examined in this manner.

Finally, the Case Study ensures that students are thinking of how to apply their audit and assurance technical knowledge without it being specifically flagged. This demonstrates that the progression through the qualification culminates in the student automatically thinking about assurance and risk without being prompted, the skill an auditor ultimately requires.