

Professional Oversight Board For Accountancy

The Professional Oversight Board for Accountancy publishes findings from review of audit quality at the Big Four Firms carried out by the Audit Inspection Unit

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The Professional Oversight Board for Accountancy (POBA), part of the FRC, today publishes the Audit Inspection Unit's findings from its monitoring of the quality of the auditing function of the Big Four firms.

Background

Following Enron and other well-publicised corporate reporting failures, the UK Government undertook a review of the regulatory regime for auditors and accountants in the UK. The report; 'Review of the Regulatory Regime of the Accountancy Profession' was issued in January 2003. That report recommended enhancing the monitoring of the audits of listed and other major public interest entities through a new independent inspection unit (the AIU) reporting to a professional oversight board (the POBA) within an integrated independent regulator (the FRC).

The AIU is taking over responsibility for the monitoring of the audits of all listed entities and other entities in whose financial condition there is considered to be a major public interest. By monitoring and promoting improvements in audit quality, it contributes to the FRC's overall aim of promoting confidence in UK corporate reporting and governance. The AIU's monitoring approach is intended to be more challenging for the major firms than in the past, focusing on judgments as well as audit processes. Consequently the AIU has developed and implemented an approach to audit monitoring for the major firms based on the following characteristics:

- Focus on the quality of auditing, with its recommendations to firms prioritised on this basis.
- Thorough, robust and challenging approach to inspection visits.
- Wide-ranging reviews of firmwide procedures, including an assessment of how the culture within firms impacts on audit quality.
- Selection of major audits for review which is largely risk-based.
- In-depth reviews of major audits, focusing on the quality of the group audit, including critical assessment of the key audit judgments made and a detailed review of compliance with UK Auditing Standards.
- Review of the quality of reporting to the Audit Committee

The report we are publishing today focuses on recommendations for improvement. This does not take away from the firms the high standards they demonstrate elsewhere in their audit work, which are not the referred to in this report.

Conclusion

The AIU's reviews of individual audit engagements indicated that the key audit judgments exercised in relation to financial reporting issues appeared, in the great majority of cases, to be both appropriate and soundly based. However, as a result of insufficient documentation, it was often necessary to form a view as to the appropriateness of such judgments on the basis of oral explanations provided. Insufficient audit documentation both reduces the effectiveness of firms' own quality control processes and makes it more difficult to adopt a monitoring approach focusing on key audit judgments (rather than an approach characterised by some as "box ticking"). The AIU referred two cases to the FRC's Financial Reporting Review Panel where it considered that there was sufficient doubt as to whether the accounting treatment adopted and/or disclosures provided complied with UK GAAP (the issues concerned did not affect reported profits in either case).

The AIU inspections identified no systemic weaknesses in the overall policies, procedures and systems of quality control operated by the firms and indicate that, when properly applied, those procedures and systems should provide reasonable assurance that appropriate audit opinions are issued by the firms. However, the AIU identified certain areas in which it considers that improvements to these policies, procedures and systems, and/or the application thereof, should be made, either to achieve compliance with relevant standards or to enhance audit quality.

The AIU believes that the risks the above matters pose for the quality of individual audit engagements should be

addressed by the firms. The AIU is in the process of making a number of recommendations to each of the firms in their private reports as to the actions it believes are appropriate to address the issues arising from its work.

Partners of the audit firms do not normally face external questioning on their audit judgments; this and the comprehensive and detailed nature of the AIU's monitoring have presented challenges to the firms, which are not underestimated. The test for the audit firms will be the extent to which they embrace and value recommendations arising from the monitoring process.

The largest firms have now had the opportunity to adjust to the new regulatory regime and the AIU will monitor the actions taken by them to implement its recommendations.

Commenting on the report Sir John Bourn, Chairman of POBA said "We found that each of the Big Four firms of auditors have the necessary infrastructure in place, and commitment, to complete good quality audits. However, where the firms do not follow their own procedures they expose themselves to the risk that future audit opinions may not be appropriate."

Sir John Bourn went on to say "We trust that all the firms will rise to the challenges which our work presents to them and expect the firms to implement our recommendations on a timely basis. We will review the extent to which they have done so during our 2005/6 inspections and report on this in our next public report in a year's time."

Notes to Editors

1. The Big Four firms of auditors subject to this first series of inspections in the period from June 2004 (when on-site work commenced) to 31 March 2005 are Deloitte & Touche LLP, Ernst & Young LLP, KPMG Audit Plc and PricewaterhouseCoopers LLP. In addition to the firm's underlying systems and procedures 27 FTSE100 and FTSE250 audits were inspected.
2. A copy of the full report can be obtained from <http://www.frc.org.uk/poba/publications/>.
3. The Financial Reporting Council (FRC) is a unified, independent regulator. Its mission is to promote confidence in corporate reporting and governance. The FRC incorporates five operating bodies: the Accounting Standards Board, the Auditing Practices Board, the Financial Reporting Review Panel, the Accountancy Discipline and Investigation Board and the Professional Oversight Board for Accountancy.
4. The Professional Oversight Board for Accountancy (POBA) contributes to the achievement of the Financial Reporting Council's own fundamental aim of promoting confidence in corporate reporting and governance. It has three main responsibilities:
 - a statutory obligation to oversee the regulation of auditors by the recognised accountancy bodies, expected to take effect formally by Summer 2005;
 - the monitoring of the quality of the auditing function in relation to economically significant entities;
 - the independent oversight of the regulation of the accountancy profession by the professional accountancy bodies.
5. The Chairman of POBA is Sir John Bourn. He is the Comptroller and Auditor General.
6. The POBA Board is independent of the accountancy profession and the accountancy firms. Its members have wide experience of business and the professions, the public sector, accountancy and auditing.
7. All press enquiries should be directed to Paul George, Director of POBA, telephone 020 7492 2340 or Andrew Jones, Director of the Audit Inspection Unit, telephone 0207 492 2360.