The Consultative Committee
of Accountancy Bodies

Audit Quality and Transparency

A study of the usage and impact of public reports on audit governance: are they providing appropriate reassurance on audit quality?

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Foreword

Audit quality is a much discussed topic following the financial crisis: is it as good as it can be? Significant efforts have been made in recent years to make audit firms and their service more transparent and to provide tools with which to appraise auditors. This includes the work of the Audit Inspection Unit and the introduction of transparency reports and the audit firm governance code. This study considers the impact of this work – are these initiatives and the reports being produced useful?

The report contains the views of a range of interviewees about the usefulness and impact of public reports on audit – reflecting a diverse range of experience and opinion and setting a base line from which to measure future reassurance on audit quality.

This project was funded and overseen by the CCAB. While only a relatively small number of interviews was conducted, we believe that the views expressed provide an insight into the usage of public reports about auditors and perceptions of audit quality and audit firm governance.

Vivienne Muir

Chair

Steering Group on behalf of the CCAB

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THE CONSULTATIVE COMMITTEE OF ACCOUNTANCY BODIES

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The Institute of Chartered Accountants in England and Wales (ICAEW)

The Institute of Chartered Accountants of Scotland (ICAS)

The Institute of Chartered Accountants in Ireland (ICAI)

The Association of Chartered Certified Accountants (ACCA)

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The Chartered Institute of Public Finance and Accountancy (CIPFA)

This booklet can be downloaded without charge from the CCAB website at:

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Contents

1. Executive summary

The objective of the project is to provide evidence on the impact of recent initiatives in connection with the publication of Audit Inspection Unit reports and transparency reports, and with the proposals contained in the Audit Firm Governance Code.

The research consisted of a series of interviews with a range of stakeholders about the awareness and usage of:

- Material published by the Audit Inspection Unit, including:
  - An annual overview report,
  - Individual public reports on each of the larger audit firms that audit public interest entities, and
  - Reports on individual audits reviewed by the Audit Inspection Unit.
- Transparency reports published by the larger audit firms, which are a statutory requirement, and
- The Audit Firm Governance Code, which is a best practice recommendation for financial years commencing on or after 1 June 2010.

In addition, the interviews explored the issue of engagement generally between audit committees, institutional investors and external auditors on audit quality and governance matters.

Our main findings were:

Audit Inspection Unit (AIU) reports

Most interviewees were positive about the AIU reports. These reports have a value because they are an independent review of the auditors and, in general, AIU reports are considered to provide a licence to operate and a 'hygiene factor' that demonstrates quality. Audit committee chairs indicated a stronger interest in the client specific 'letter' from the AIU than the audit firm report, perhaps because they focus on their audit team rather than the whole audit firm. As far as the audit firm reports are concerned, audit committees draw comfort from the fact that such reports exist, rather than from their detailed content; there seems little enthusiasm among institutional investors for direct engagement with auditors on the basis of AIU reports.

Transparency reports

There was less awareness of transparency reports than either AIU reports or the audit firm governance proposals and their usage so far is relatively limited. Among those who are aware of them, the perceived value at this stage is uncertain. Views were mixed as to whether the transparency report could be used as a basis of demonstrating how a firm achieved quality of service and quality of staff, whether they would be 'glossy' marketing opportunities or whether they would become boilerplate and therefore of little use.

Audit Firm Governance Code (AFGC) proposals

Most interviewees were aware of the audit firm governance code: its perceived value is in major audit firms introducing governance structures that are applied elsewhere in the commercial world; particularly the role of independent non-executives, the publication of a statement of the firms' values and the opportunity for dialogue with stakeholders. The role of non-executives in helping to protect the public interest was a recurring theme in discussions. There was considerable support for the code but less enthusiasm among audit committees and institutional investors for engagement with auditors on audit firm governance matters.

On the issue of engagement generally, all stakeholder groups had reservations about dialogue between auditors and investors, particularly at an individual client level. Institutional investors stated their preference for engagement at individual company level through the audit committees, whom, they believe, have the primary responsibility for monitoring the individual audit process.

Audit committee and institutional investor interactions with external auditors

Audit committee chairs were more interested in the performance of the audit team and generally had little interest in engaging on firm governance issues. Neither auditors nor institutional investors were keen to engage with each other at individual client level and there was a lack of a framework for such engagement. Audit committee chairs were also uneasy about such direct interaction between auditors and investors. The general consensus among institutional investors and their representatives was that if they had concerns about the auditors of a particular company, they would discuss these with the audit committee, which was seen as having a key role in monitoring external audit quality. Although one of the aims of the AFGC is to provide a basis for enhanced dialogue between institutional investors and auditors, investors for the most part did not consider that dialogue with auditors about their firms' governance would be useful to them.

The role of professional bodies and regulators in relation to the reports

The Financial Reporting Council (FRC), largely through the Professional Oversight Board (POB), is taking responsibility for monitoring the reports produced by audit firms and engaging with firms to improve their quality. Interviewees agreed that this arrangement was appropriate. Professional bodies are also thought to have a role to play, in the public interest, to promulgate best practice, to raise awareness of the issues and to encourage firms in complying with the spirit as well as the letter of the requirements. However, professional body representatives interviewed have no plans to monitor the quality of reports.

Perceptions of the impact of the reports

Some investor representatives and regulators saw the potential for the reports to improve audit quality. Most interviewees, however, did not believe that the governance and transparency reports would improve audit quality to any significant extent. Several interviewees also thought that AIU reports would only have a marginal effect on quality because they believed that there were already no major systemic weaknesses in the UK among public interest auditors. There was a view that the fact that the firm was going to be reviewed was as much a driver of improvement as the review itself.

The impact of the AIU reports on the perceptions of the audit profession was viewed positively as they give assurance that the work is being done properly. The lack of major problems will improve perceptions of the quality of the audit process, and the transparency and governance disclosures will demonstrate that auditors are interested in promoting awareness and take these matters seriously.

The future policy implications from this project for the FRC and CCAB bodies

The objectives of the project are to provide evidence on the success of recent initiatives on publication of AIU reports, transparency reports, and the AFGC proposals with a view to providing constructive input into future policy direction for FRC and CCAB bodies.

In general, the interviewees considered that the FRC should take a lead role for monitoring quality of reporting. Professional bodies saw themselves in a more supporting role, encouraging high quality reporting but not monitoring it. The AIU reports are considered to be more important for this than the transparency reports.

The role of the audit committee is seen as key. Both auditors and institutional investors preferred to engage with them and there were calls for the audit committee's report to be strengthened to include an appraisal of the auditors. Institutional investors preferred to engage through the audit committee and there was no appetite for direct engagement with the auditors on audit firm governance, although a minority saw the possibility of a more general engagement perhaps at audit firm or even professional body level.

There was general agreement that the proposals for audit firm governance were of value but that best practice needs to be allowed to develop in an environment of continuous improvement. Parallels were drawn with the Combined Code, which has gone through a number of iterations and has gradually improved the quality of UK corporate governance.

The report has a number of recommendations for stakeholders, which are detailed at the end of this report.

2. Introduction and background

The objective of the project is to provide evidence on the success of recent initiatives to provide further information on audit firms by the publication of Audit Inspection Unit (AIU) reports and transparency reports and the potential impact of the Audit Firm Governance Code (AFGC) proposals. The project also considers whether these reports are being used effectively and are meeting their objectives, and it assesses their impact on audit quality.

This study comprises 18 interviews with stakeholders to the external audit process on their usage of the reports, their awareness of the audit firm governance code, and the extent to which these could facilitate greater engagement between the stakeholders and external auditors.

Audit Inspection Unit reports

The Audit Inspection Unit is part of the Professional Oversight Board (POB), which is a board of the Financial Reporting Council (FRC), and is responsible for the monitoring of the audits of listed and other public interest entities in the UK. The Audit Inspection Unit issues reports at three levels. There is an annual overview report, which analyses key overall findings from its audit inspection work. In addition, the AIU publishes individual reports on the findings of their annual inspections of each of the audit firms. The AIU also provides a report on each individual audit which it has reviewed to the relevant audit firm with a view to the report being made available to the audit committee of the company concerned. This has been in place since January 2008.

Transparency reports

A transparency report is a statutory requirement that needs to be produced by each of the audit firms that audit public interest entities and it applies to the firm's financial years commencing on or after 6 April 2008. The report should be published annually and contain information on *inter alia*, the firm's legal and governance structures, its internal quality control system, its independence procedures and practices and certain financial information.

The Audit Firm Governance Code

The Audit Firm Governance Code (AFGC) was published in January 2010 by a working group of the Institute of Chartered Accountants in England and Wales (ICAEW) on behalf of the FRC. The AFGC applies to eight audit firms that together audit 95% of companies listed on the Main Market of the London Stock Exchange and sets out a benchmark for good governance, including the requirement to state the principles by which the firm operates, to appoint independent non-executives and to engage in dialogue with stakeholders. The working group recommended that the Code should apply to firms' financial years commencing on or after 1 June 2010. The Code requires extensive disclosures in both the transparency report and on the firm's website of its governance arrangements.

The interview process

A total of 18 interviews were conducted with representatives from six stakeholder groups as indicated in Table 1 below. Interview extracts appear in the report in italics and Table 1 shows the codes inserted at the end of each interview extract to identify the category of interviewee:

Table 1 Interviewees

Stakeholder group	Code	Number
Audit committee chairs	AC	3
Investor representatives	IR	4
CCAB body representatives	CB	4
Government and regulators	GR	2
Audit partners	AP	3
Accounting academics	AA	2
Total		**18**

The interviews averaged around one hour in length and were semi-structured around key questions (Appendix 1) which were tailored as appropriate for each stakeholder group. 16 interviews were conducted face-to face and two were by telephone. 17 interviews were recorded and transcribed in full. One interviewee did not wish to be recorded and notes were made by the interviewer at the time of the interview.

The project set out to ask the interviewees about each of the reports and the governance proposals: what was the perceived purpose and usage of the reports and what level of user engagement did they generate? The reports are designed to improve audit transparency, to support and improve audit quality and to assist stakeholders when making a choice of auditor. However, despite the common objectives the reports differ from one another. AIU reports are produced by an inspection process that is external and independent from the auditors and all other stakeholders: it is itself a form of 'audit'. Transparency reports require the audit firms to produce their own reports on structure and governance of the audit practice, whilst the AFGC is a 'comply or explain' code of governance for the accountancy firms, the details of which are to be publicised in the transparency reports and on the firms' websites. These are relatively recent requirements and, therefore, the project sought to establish a base line to evaluate initial perceptions and usage of the information.

3. Interviewees' perceptions of the reports and governance proposals

3.1 The Audit Inspection Unit reports

The perceived value of AIU reports

There was little interest in the annual overview report but interviewees thought that the firm reports and the client letters were useful because they made the invisible audit process used by the firms visible. Unlike the transparency reports and the governance disclosures, they were an independent review. The AIU reports did not indicate the existence of systemic problems which, while not unexpected, was reassuring for clients and accounts users. From the audit firm's perspective:

> *...it is beneficial to have someone externally to come in and validate the things we are worried about. (AP)*

As one professional body representative put it:

> *The way most consumer protection type regulation works is as a hygiene factor. The consumer takes confidence from the fact that somebody is licensed to provide that service. (CB)*

User engagement with AIU reports

Although users took comfort from the existence of the review process and the reports, there were mixed views on the level of engagement by audit committees with the reports. The FRC expects client letters to be shared with the audit committees of the companies concerned. Audit partners and audit committee chairs interviewed confirmed that this usually happened.

However, there was less consistency in relation to the firm reports. One audit partner described how he proactively discussed the firm report with audit committees, concentrating on specific areas they were interested in and explaining what the firm was doing to rectify the AIU's criticisms. Another partner said that the firm reports were sent to clients but not discussed. A third partner thought that clients were just not interested, as issues such as firm and team independence were already discussed with individual clients on an ongoing basis.

Audit committee chairs tended to draw comfort from the existence of the AIU report rather than its detailed content.

> *This is regulation. I expect the FRC through the AIU to set up a framework and I don't think it's my place to go and start looking into this sort of thing. I just want to know that it's happening. (AC)*

Audit committee chairs focused more on their relationship with the local partner and audit team than with the firm unless the company was thinking of changing its auditors, when audit committees would scrutinise firm reports as part of the tendering process. The view was that if there were problems at firm level, this fact was likely to be in the public domain anyway. Non-executives would tend to focus on the likely impact on their company, such as a loss of firm reputation or questions on the ability of the firm to service the company.

> *It's team up rather than firm down. (AC)*

On the other hand, this may change in the future as the level of engagement between audit committees and auditors increase, and the AIU reports could form an important part of that greater engagement.

One audit committee chair stated that he requests the firm reports and discusses them with the partner.

> *We asked for these (firm reports), which surprised them, but they produced them. And all the other guys on the audit committee started asking for the same thing. That's what happened. It exploded. When they realised that it was available they wanted to see it. (AC)*

In his view, as audit committees engage more with auditors, they will see the importance of output-based information such as the evaluation of the quality of audit judgments and quality control mechanisms within the firms. One regulator interviewed agreed:

> *Audit committees would tend to concentrate on outputs from the audit process rather than inputs. They would only drill down into the inputs where there are issues raised by them or by the AIU. (GR)*

A professional body representative pointed out that there was much in AIU reports that audit committees should be concerned with – e.g. the quality monitoring procedures, policies for rotation and the provision of non-audit services. A regulator interviewed suggested that:

> *If there are serious criticisms of a firm then I would expect the audit committee chair to engage with their audit firm on these issues… Audit committees need to think about the risks to their own audit quality and that should drive which topics they wish to engage with the firm most significantly on. (GR)*

There was little enthusiasm among institutional investors for direct engagement with auditors as a result of AIU reports. While they acknowledged that audit quality was a relevant issue to them, they did not anticipate engaging with firms on a routine basis. Their main focus is on a potential investee's business strategy and operational issues. A typical comment from investor representatives was:

> *I think there is an interest among the corporate governance world in those (AIU) reports and that is helpful. But again, it's not something which seems to resonate with the average investment manager… I think there are a few institutional investors who do [want to know more about their auditors] and there are more who don't, frankly. (IR)*

If problems arose with particular firms, then they might refer to the AIU reports after the event, to try to understand what went wrong, to determine whether it was a firm-wide, audit or office-specific issue.

Perceptions of the AIU approach

Auditees thought that the AIU's approach appeared to be too document-driven, concentrating on process rather than judgment. There was also concern from audit committee chairs that auditors were spending disproportionate amounts of time on the AIU inspection process. One audit committee chair said he thought the process was "quite stifling" for auditors and that an audit partner had told him:

> *… "as a partner I have spent more time with the AIU than with the firm when I actually audited your company." Well, hold on a second. That doesn't make sense. (AC)*

Audit partners, though, felt that, while it was inevitable that there would be some attention to process, there was not too much preoccupation with documentation of the audit at the expense of quality of audit work in the AIU inspections. The firms' own internal review and quality control procedures meant that there was no need for major pre-visit file updating work to be done. As far as the reviewers were concerned:

> *They look at judgment now more than they did, I think. Now that they know all the firms and their methodologies better I think they've got a very good handle on how the process works. So, now they are looking at judgments. (AP)*

Two audit partners had criticisms of AIU inspectors who tried to "second-guess" judgments that had already been through complex firm quality control procedures but it was recognised that AIU inspectors had the right to challenge judgments they felt to be inappropriate.

Audit partners admitted that they found the AIU visits time-consuming and one partner, while recognising the importance of what the AIU were doing, did not consider that the quality of their reports was proportionate to the work put in.

> *I think one of the biggest frustrations we find is a lack of ability to articulate the points of view clearly in the reports so we spend quite a lot of time just going through drafts of the reports to actually fine tune the wording so it's clear what they are trying to say. (AP)*

Several audit partners and professional body representatives commented on the danger of ambiguity in reports. For example:

> *The difficulty is reporting it in a way audit committee chairmen can understand... What you don't want is the audit committee chairman having our proposal saying how brilliant we are and then the AIU report not really calling it one way or another, but listing things that seem likely they're not right and the audit committee chairman is left thinking "where does that leave me?" (AP)*

> *AIU reports have got to tread a very careful line between showing that they're doing a thorough job... and not causing undue alarm and despondency. (PB)*

Overall, two of the three partners interviewed valued the external AIU inspectors' input. The third partner thought there was no benefit to the firm; it was just a regulatory process that had to be followed.

In summary, the AIU inspection process and the resulting firm reports and client letters were thought to be useful to demonstrate audit quality. However, at present there is little enthusiasm for engagement with firm reports by audit committees. A minority of interviewees did think that this would change and pointed out the importance of some of the content to audit committees in executing their responsibilities. If concerns expressed about the clarity of reports and the perceived ambiguities in the message can be resolved, the potential exists for firm reports to be used proactively by auditors in their engagement with audit committees. We only interviewed a small number of auditors but it was striking that, among the sample there was a very wide range of views from those who thought there was opportunity to use the reports proactively to those who simply expressed reservations about the benefits of the inspection process.

3.2 Transparency reports

The perceived value of transparency reports

Regulators argued that the level of transparency of the reporting of audit work in the UK is greater than anywhere else in the world and that audit committees should welcome this as an opportunity to ensure that audits and auditors continue to meet their needs. The existence of the transparency reports is intended to give basic assurance that firms have a degree of internal accountability.

Some interviewees in each of the stakeholder groups of audit partners, regulators and professional body representatives saw an opportunity for firms to be innovative in driving improvements in and competing on audit quality. It was argued that there are a number of areas within transparency reports that should be of particular interest to audit committees and investors such as the internal quality control systems and the ways in which firms maintain staff expertise. Firms could be differentiated on the basis of quality of service and quality of staff and transparency reports could be used as a basis of demonstrating how the firm achieved quality in these two areas. It was not clear, however, how such quality of service and staff could be measured and reported on in an objective manner.

Concern was also expressed about the content of the reports and the "pedestrian nature" of the language used. Too few firms appear to be giving explicit confirmation of how procedures operate in practice and it was often not clear how much influence UK firms had at international level. There was suspicion that the documents contain "too much glossiness compared to substance" as one investor representative put it, and several interviewees thought that the firms would compare themselves with others and standardise what is being said.

> *There is a danger of it all being arbitraged down to boilerplate. (AP)*

User engagement with transparency reports

Audit committees have so far shown little interest in transparency reports. One audit committee chair, admitting he had never seen a transparency report thought he might "skim it for about 20 seconds." Typical comments were:

> *These reports will not convey very much to us. We're glad they've thought about it. Public statements are... nice to have... but I wouldn't personally use them. (AC)*

> *It's neither causing angst nor interest, frankly... It's just a given on the part of the non-executives. We would expect large accountancy firms to give this kind of information. (PB)*

Audit partners confirmed that the transparency report section of firms' websites indicated little usage. One audit partner thought that non-executive directors would find no value in the reports, and possibly were unaware of their existence. There were mixed views as to whether this was due to lack of user interest or lack of interaction with users by audit firms and there is a danger that if firms think users will not be interested in transparency reports they will not draw them to their attention. One investor representative commented on transparency reports that:

> *I haven't actually read a transparency report. Nobody has bothered to send me a transparency report... It's all very well having things available on websites but people have got to move them off websites. (IR)*

There is a view among some auditors that the transparency reports are not an appropriate vehicle to distinguish firms or to compete on quality and that spending time honing the report and fine-tuning the wording would not be worth the effort.

> *I think we feel that there is no benefit from going that extra mile because to the extent the outside world is interested in it, I suspect they want to know that you've actually met the minimum acceptable standard... I don't think there is a lot of difference between the firms anyway in terms of the extent to which they do or don't go beyond the bar and even if you tried to demonstrate that I don't think it would make a great deal of difference in the eyes of our clients. (AP)*

However, other interviewees were more positive. One audit partner suggested that if a firm actively used the report as a basis for discussion with audit committees and institutional investors, it could become an instrument for greater ongoing user interaction. In his experience, good audit committees are alive to the question of auditor quality and willing to engage on these issues.

> *If we just send it round to our clients I don't think that would achieve a lot because it would just end up on a shelf, forget it. (AP)*

Instead, auditors had to share their transparency report with clients.

> *It's difficult to make it accessible without it seeming to be a proposal or a load of spin because the tone is dry and factual… [but]… you have a 30 page reference book on audit quality and if you're responding to a question from an audit committee or the press you can draw from there what you need because that's the bit you do need for the individual contact. (AP)*

The investor community do not appear as yet to have engaged with transparency reports. As with AIU reports, some investor representatives thought user interest in transparency reports would develop as interaction between auditors and users increased and they may be a future source of information for investors in the future.

> *The transparency report is a very important step forward which shareholders ought to be encouraged to use as a live document. I'm surprised how few people are actually saying they know they exist. (IR)*

The extent to which they will be used depends on the quality of the information produced. One investor complained that, at present "there is comparatively little straw for us to make bricks with". However, interviewees were optimistic that the quality of what is produced will improve with usage.

> *As with all these things, if clients are using them and questioning them then they [auditors] will improve the quality and will use them for real themselves. (IR)*

Another investor representative agreed:

> *It may start off as elegant boilerplate but I'm heartened because if we envisage dialogue with audit firms based in part on what's in the transparency report and it's not very informative then that will be a good area to push back on and ask for more information. (IR)*

In summary, some interviewees saw the potential for transparency reports to be used as a basis of differentiating the firms, improving audit quality and forming a basis for productive dialogue with clients and investors, but this was by no means a universal view. There is a perception amongst a number of stakeholders that there is little incentive for the improvement of audit quality above a base level so transparency reports would not be an appropriate vehicle for differentiation. It is not clear whether a transparency report is seen simply as a regulatory requirement or whether it could be used as a means of promoting the firm.

3.3 Audit Firm Governance Code

The perceived value of the audit firm governance code

There was wide recognition that such a code is necessary. Because of the limited choice of auditors that are used by public interest entities, the sheer size of firms and their impact on the economy there is a high degree of public interest in effective audit firm governance. The big challenge is to encourage compliance with the spirit of the code.

One institutional investor confirmed that the code had received a favourable response from investors generally. Another investor summed up the views of several interviewees as:

> *The fact that steps have been taken to introduce governance structures which are applied elsewhere in the commercial world makes a lot of sense (IR)*

User engagement with the audit firm governance code disclosures

While recognising that the code is an important innovation several interviewees doubted that the disclosures would be read. One audit committee chair did not believe it was his place to look at that level of detail. Others thought disclosures would inevitably be boilerplate or "a lot of gloss". As with the transparency report, it was thought to be a good thing to have in the background but not something that would be examined in detail.

On the other hand, several interviewees across all categories thought that clients and investors would scrutinise the calibre of non-executive appointees, and firms appointing weaker non-executives would suffer reputational damage.

The view was expressed that, apart from the introduction of non-executives, there is very little that is not happening already, so, although it was viewed positively, it was not likely to bring about major changes. As one investor representative said:

> *What they've come out with is actually quite sensible but if you look at the governance of the profession… there is a lot of it going on anyway so what bit was missing that made this a really compelling document? I'm not sure what apart from the independent non-executives… is in here that is going to make a huge difference. (IR)*

Perceptions of the audit firm governance code

For non-executives and institutional investors the most important aspects of the code were the signs of openness and transparency at the top and a sound ethical culture. Users expressed an interest in procedures for disagreement resolution, independent internal reviews and partner reward structures. Discussion tended to become focused on three main areas: the role of independent non-executives, the statement of the firms' values and the opportunity for dialogue with stakeholders.

With the exception of one audit partner, all interviewees were positive about the appointment of non-executives by the firms. They had the potential to bring a new dynamic to the way the firms operate and help to change any narrow inward focus. Although the firms' governance model differs from that of a listed company in that there is no separation of ownership and control, non-executives have a role to play in protecting the public interest. One audit partner stated that in audit firms:

> *…non-executives are more to protect the investors in the markets because the stability of the capital markets is something that we auditors are important to and the world at large has an interest in that. So it's that substitution of public interest for direct shareholders. (AP)*

The role of non-executives in helping to protect the public interest was a recurring theme in discussions; they could make sure the public interest dimension was not forgotten on a day to day basis; they could:

> *..encourage career auditors trying to maximise revenues not to go off the rails. (AC)*

One institutional investor summed up his view of the non-executive's role as:

> *They should have effective oversight of the whistle blowing mechanisms and some visibility of what is actually being said by people on these things. They should be concerned about the tone from the top and the succession planning and the characteristics of the people that are associated with (the firm) and they should be listening to the views of stakeholders in terms of both negatives and positives. (IR)*

Although interviewees were positive about the appointment of independent non-executives, they warned that their ability to be effective depended on the quality of the people, the mindset of the firm, the environment in which they were working and the extent of their understanding of the organisation. The ultimate sanction for non-executives is to walk away from a bad situation:

> *The nuclear option for non-executives is to resign. So it is in the enlightened self-interest of audit partners to do the right thing because it impacts on reputation. (IR)*

Resignation is an extreme measure and it is only likely to be exercised in exceptional circumstances. So, although most interviewees thought that there was considerable potential for non-executives to have a positive impact on the governance of audit firms, the audit firm governance initiative is at an early stage of development and it is still a case of "watch this space".

On the whole, interviewees were positive about the explicit statement of the firms' values. The mere statement of these would not "convince an unbeliever" and a few interviewees cynically regarded the statements as "platitudes" but it was recognised that such disclosures do encourage the leadership and staff to think about these issues. Most importantly, explicit statements could provide material for non-executives to call the firm's executive to account by demanding to see how these principles are operationalised.

In the interviews, we explored the issue of engagement generally between institutional investors and external auditors on audit quality and audit governance. There were reservations about dialogue between auditors and investors, particularly at an individual client level. Audit committee chairs expressed their unease at such a dialogue and several interviewees thought it would be impractical and result in huge consistency, legal and information asymmetry problems. Institutional investors stated their preference for engagement at individual company level through the audit committees, whom, they believe, have the primary responsibility for monitoring the individual audit process.

Notwithstanding the fact that one of the aims of the code was to provide a basis for enhanced dialogue between institutional investors and the audit firms, neither audit committee chairs nor institutional investors appeared interested in having dialogue with auditors on governance issues.

Typical comments were:

> *I'm not interested in talking about governance. I've got more important things to do. I just don't see that I'm going to get anything out of that. (AC)*
>
> *Is there anybody out there clamouring to know (about firm governance)? You can't get shareholders interested. Audit firms would be prepared to talk but there is no demand for it. (AC)*

In summary, although there was considerable support for the code, there appears to be little enthusiasm for engagement with auditors on audit firm governance matters. Audit committees and investors seem largely content to know that these provisions exist.

4. Audit committee and institutional investor interactions with external auditors

Both types of report, the AIU reports and transparency reports, and the AFGC proposals have the underlying aim of increasing transparency and awareness amongst the stakeholders in the audit process. With this in mind, interviewees were asked about their relations with other stakeholders and their level of interaction.

Interaction of audit committees with external auditors

Under the terms of the UK Corporate Governance Code audit committees should review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process. Auditors and auditees interviewed confirmed that audit committees engaged with auditors, prospectively discussing audit plans and retrospectively discussing audit findings. Audit committees also evaluated audit team performance in discussion with executive management.

Audit committees were more interested in audit team performance than audit firm issues, though the impact of any firm-level concerns would be discussed with the audit partner to the extent that they were likely to impact on the specific audit – e.g. problems in particular countries or reputation issues. Audit committee chairs would discuss concerns with the engagement partner but, if necessary, were prepared to bypass the partner to talk to the senior regional partner or the firm's executive.

Audit committee chairs confirmed that boards have some input to the choice of replacement when audit partners are rotated, describing how, typically, a short list would be drawn up and they and the finance director would interview them and decide.

> *The main aim is minimum disruption, maximum harmony but maximum effectiveness. (AC)*

Audit committees are less interested in firm governance matters. One audit partner reported that:

> *Audit committees are more interested in performance than governance. I'm not aware of any partners getting questions on governance at all. (AP)*

Audit committee chairs confirmed that they regarded these matters as the "the auditor's business". However, it was pointed out that non-executive directors and audit firms engage on a more general basis and this might be more appropriate for governance discussions.

> *There are other fora which take place at the instigation of the firms themselves, the institutes, to some extent the regulators, which provide opportunities for non-executives and auditors to engage in a broader sense and discuss matters of mutual interest. (CB)*

One audit partner described how firms can interact and engage with non-executive directors by inviting audit committee chairs to attend seminars and CPD activities.

> *All of this is about trying to sell more of their service but it's a very soft sell because it's really about engagement. (AP)*

Interaction of institutional investors with external auditors

The AFGC seeks to encourage institutional investors to take an interest in the firms that are appointed to audit the companies in which they invest. The AFGC is to be applied to firms' financial years commencing on or after June 2010 so it is too early to analyse its impact. However, we wished to establish a baseline, to find out what level of interaction there is between institutional investors and external auditors, and whether the parties thought that the different reports would assist.

Neither auditors nor institutional investors were keen to engage with each other at individual client level. Auditors were concerned about issues of confidentiality and the need for safe harbours. All interviewee groups felt that there was a lack of a framework for such engagement.

> *I don't think it's right that auditors have a direct line into shareholders in an uncontrolled way. I think that's fraught because where do you draw the line between fact, audit judgment and opinion. (AP)*

Investors argued that they had little interest in evaluating auditors at engagement level.

> *Auditor performance is not something which most investors are going to take a great interest in because the bottom line is they treat the accounts as a given, as it were... It's not something that is going to resonate with the average investment manager. (IR)*

> *The calibre and reputation of the audit firm is probably as much analysis as we would do. (IR)*

Institutional representatives commented that it is only if there were problems within particular investee companies that institutional investors might consider the auditors but these problems would be addressed as a group action at a higher level, with the primary aim of recovering lost money.

Audit committee chairs were also uneasy about direct interaction between auditors and investors:

> *I would be quite uncomfortable if they were talking about my company. It would undermine the executive and the board generally. (AC)*

One perceived barrier to communication is the nature of the audit report. The present ISA 700 report is a standard document that closes down the possibility of discussion and, in the absence of a qualification, is not commonly read by institutional investors. It was suggested that if the auditors made more company-specific comments in the report on issues such as major risks, uncertainties and areas of judgment, this would promote more engagement by investors.

> *I think it would be hugely beneficial to get an understanding of areas that the audit focused on... to get a better understanding of what auditors thought were the main risks of the business, what issues they found, areas of weakness, areas of strength. (IR)*

One audit partner agreed but suggested that the ability of auditors to comment on such matters depended on a fuller disclosure by the directors in the management commentary and other narrative sections of the annual report.

> *If companies disclosed more at the front end – risks and how these are addressed, auditors could perhaps comment on these. (AP)*

One regulator thought that engagement between auditors and investors "at the generic level" was a potential contributor to audit quality.

> *I think that investors need to engage in the debate on audit quality because that will encourage auditors to (a) recognise who they are there to serve and (b) step up to the mark where perhaps they're not doing so. I think there is a bit more of a challenge for investors to be engaged in a dialogue with auditors on a specific audit engagement. (GR)*

An audit partner expressed his firm's interest in such interactions with investors at the representative body level.

> *The English Institute has the audit quality forum and invites investor participation at the macro level and we do things with investors at the firm – but universally the difficulty you have is just getting them engaged in the subject really... I suppose you take comfort from the fact that because not many people come, then there is probably not a big problem out there! (AP)*

This sheer lack of interest was evident in discussions with some investors. One stated that he did not see any benefit in discussing audit firm governance arrangements with the firms.

> *I don't believe it is institutional investor responsibility even though we might be deemed to be a stakeholder in appraising the governance issues. I would regard that as a responsibility of the client who's actually appointing KPMG, PwC or whoever to carry out the audit of their business. I would imagine that it should be their responsibility to be comfortable with this firm as having resources available as well as an appropriate governance structure. (IR)*

The role of the audit committee and interaction with institutional investors

The general consensus among institutional investors and their representatives was that if they had concerns about the auditors of a particular company, they would discuss these with the audit committee, which was seen as having a key role in monitoring external audit quality.

> *I would like to see this pushed back onto the audit committees. You have chosen to appoint KPMG (or whoever); you are going to recommend their reappointment at the next AGM. What have you done to satisfy yourselves that in fact they are the best equipped to do the job for you?.... I want to see the audit committee report expanded to include a review of the auditors, to confirm that actually this firm within those particular bounds, is appropriate for us. (IR)*

Another institutional investor agreed, suggesting that audit committees needed to "raise their game" in this area.

> *Maybe the reports of the audit committees should be placing more emphasis on these sorts of issues [audit firm technical and governance matters]. What have they done to appraise themselves that audit firm X is still up to the job? (IR)*

A third investor thought that there would be increasing engagement with audit committees on audit firm performance.

> *I expect ... that there will be progressively more questioning of audit committees as to how they have evaluated the auditors for that particular company and the AIU reports will go with that and be factored into that evaluation... I do envisage that over a three or four year period we may see audit committees progressively starting to engage regarding the types and levels of assurance that shareholders are looking for. (IR)*

Future interaction between audit profession and institutional investors

One audit partner also raised the possibility of dialogue helping the evolution of the audit process to meet user needs but he saw this as taking place at firm or even professional body level.

> *The theory is to get both parties together and have some sort of exchange of information... The profession and the firm are quite interested to say to investors "it is evident that there are things not being done that you might like to be done and we're not quite sure what they are but if you could tell us that might be jolly useful because we might be able to do some of them". (AP)*

One professional body representative saw the possibility of interaction with investors producing ad hoc audit arrangements, tailored to meet specific needs.

> *A couple of the more forward thinking of the Big Four partners have said that maybe there's more scope for bespoke arrangements. If an investor group wants to get some specific assurance about a particular company, then they can pay for it and they will get a private report back. But you have to be careful about favouring a particular group of shareholders in that way. (PB)*

Some investors, while not enthusiastic about direct engagement on a client-specific basis, were interested in a more general engagement at a higher level on governance issues.

> *There is likely to be a more regular and systematic dialogue with the audit firms regarding their governance and dynamics which will help to inform your perception of their style and their differences if one could discern a difference… The modus operandi for that is at best uncertain but I suggest it will probably be done substantially at the representative body level, where individual investors may participate in one to one dialogue between audit firms and investors… will be best done in parallel with that…. It's not inconceivable that in five or six years' time you will have firms like PwC going on a roadshow. (IR)*

In summary, it was apparent that in the various relationships between different stakeholders the interaction between the external auditors and the audit committee tends to be strongest. Both parties have defined roles and a common interest; both parties have an awareness of the drive towards audit quality and the tools available to support this. It is still at an early stage to evaluate the use that Audit Inspection Unit reports, transparency reports, and the audit firm governance code will be to these parties.

Audit committees are increasingly engaging with auditors on team performance issues, but there was less interest in engagement at individual company level on firm governance. However, opportunities do exist for client company non-executives and auditors to discuss issues of mutual interest, including governance matters at a more general level. Institutional investors were not keen to enter into dialogue with auditors at investee company level but relied on audit committees to confirm that the audit firm was "fit for purpose" in the areas of both effective team performance and effective governance. Some institutional investors anticipated that there would be increasing pressure on audit committees to address wider audit governance issues and to report their findings to investors.

A small number of institutional investors were positive about direct engagement with audit firms at a more general level and, together with the auditors, saw this as having the potential to develop the audit process and change the emphasis of the audit report. This liaison could also contribute to a greater mutual understanding of needs and constraints.

On the other hand, there is presently a general reluctance among most institutional investors to engage with auditors as they do not see any benefit in doing so. It may be that engagement will be limited to the interested few.

5. The role of professional bodies and regulators in relation to the reports

The FRC, largely through the POB, is taking responsibility for monitoring the reports produced by audit firms and engaging with firms to improve their quality and in May 2010 the POB produced a report on the quality of transparency reporting by professional firms. Interviewees agreed that this arrangement was appropriate. One regulator commented:

> *The POB will examine and sort out the quality of the reports and disclosures coming from the firms and communicate their views. They are skilled in analysing the quality of the reports coming out of the audit firms and can read between the lines to identify problems or particular pieces of boilerplate. (GR)*

Another regulator explained:

> *The regulator does a very intrusive inspection and, as part of that inspection, gathers a lot of information including transparency reports. Where they think those transparency reports do not reflect what is actually happening they will call those firms to account… At a more general level a huge amount of information is published including an overview report on the state of the nation of auditing in the UK. No doubt they will, at some point, think about whether they should say anything publicly about the operation of the code. (GR)*

Professional bodies are also thought to have a role to play, in the public interest, to promulgate best practice, to raise awareness of the issues and to encourage firms to comply with the spirit as well as the letter of the requirements. However, professional body representatives interviewed have no plans to monitor the quality of reports.

> *I wasn't planning to do that (monitor reports and comment to the FRC). Maybe I should. It's worth pondering but I think there's no intention to do this. (CB)*

Another professional body representative thought that their duties should be limited to encouraging best practice among their members.

> *I believe that the professional bodies have a duty to raise awareness in the sense of commenting and supporting the individuals, the firms and the regulators through the process. I think you've got a pivotal role as professional bodies to play in that context. (CB)*

Audit partners, while believing that the quality of work done by regulators was improving, appeared unsure of exactly how firm monitoring would evolve. One partner expressed his concerns that "league tables" of audit firms might be prepared.

> *If I was a regulator I would want to reinforce audit quality. I wouldn't be wanting to differentiate between firms on the basis of audit quality because that would make the competition issue even more pronounced. (AP)*

Other auditors were more positive about the impact of public scrutiny.

> *If one firm does more than another, if there is public scrutiny it must push the weaker firm up. So, across all the firms it can only be driving improvement because the highest common denominator starts to prevail…. The regulators can now be a bit more open about it and say "you know, over at Firm X they do this a bit better than you, we think, so why don't you think about doing it that way?" That also drives the need for us to continue to improve because the regulator is continually telling us what we need to do. (AP)*

In summary, so far the Financial Reporting Council is taking the lead role through the Professional Oversight Board for monitoring the quality of firm reporting and professional bodies saw themselves in a more supporting role. Uncertainties remain as to whether firm reporting, with transparency reports and the audit firm governance code, will be a driver towards a general improvement in audit quality or a differentiation tool. This may be because the purpose of a transparency report remains unclear – does it have a clear regulatory objective or are regulators encouraging its use as a vehicle in which to promote the firms.

6. Perceptions of the impact of the reports

The impact of the reports on audit quality

Most auditors and professional body representatives interviewed did not believe that the governance and transparency reports would improve audit quality and thought that the AIU reports would only have a marginal effect on quality. This was because, as the AIU reports have indicated, there are no major systemic weaknesses in the UK among public interest auditors. Any improvements are likely to be in relation to the rigour with which firms' procedures are applied to a particular audit. Some interviewees suggested that best practice based on points made in AIU reports could percolate down below the larger audit firms.

> *Having best practice at the top level is always a spur to those lower down because if they're saying "we'd like to compete with these guys eventually" then having something like this is a way of saying "we're going to try and comply with this and do it their way and by so doing haul ourselves up by our bootstraps". (IR)*

In the largest firms, audit partners thought that there could also be a continuous marginal improvement as firms learn from each other and bring standards up to best practice, particularly in the areas of documentation quality. There was a view that the fact that the firm was going to be reviewed was as much a driver of improvement as the review itself.

> *[Over the period of the AIU inspections] our processes and procedures have improved, so perhaps it was a result of knowing that there's an external body that was going to come in and knowing that there were external reports that were going to be publicly available, but I think we were going to do it anyway... If I go back, we probably weren't all that good at documenting decisions because the partner knew what had been decided... Now, there are memos, it's all set out, so it's clearer, there's no doubt about it. Are we doing a better audit as a result? I'm not sure about that, probably better evidenced. (AP)*

Audit committee chairs also tended to think that the reports would not have a major impact on big firm audit quality.

> *Will it improve audit quality? I'm not so sure. I think audit quality comes from the firms continuing to employ and invest in good auditors, that there is sensible regulation of the profession, that sensible standards are set up for both accounting and auditing and that the whole is properly rewarded so you continue to get good people going into it...While there have been banana skins a lot of good things are actually done and (auditors) keep businesses by and large on the right track. (AC)*

Some investor representatives and regulators did see the potential for the reports to improve audit quality. As one investor bluntly stated:

> *If it doesn't improve the quality of the audit nothing else really matters (IR)*

It was argued that, unfortunately, auditors appear reluctant to perceive "quality" as being more than meeting the regulatory requirements and no more.

> *This is my overall concern with transparency reports in particular – there is limited competition between audit firms on audit quality and part of that is because there is a lack of understanding on what audit quality is. Secondly, I see there is a lack of innovation from audit firms to try and be innovative in driving improvements in quality. I think if firms used their transparency reports more explicitly to compete on quality then I think that would serve the industry well. (GR)*

> *The rate of progress in getting from the rhetoric to the reality has been constrained by a wish to do little more than the regulatory minimum and wait for the regulators to move... The rhetoric has been heading progressively in the right direction for the last five years but reality is lacking at too many levels. (IR)*

It was recognised that it has to be the profession which drives audit quality forward. However, it is difficult to know how audit firms can be motivated to push out the boundaries of audit quality in the present audit market. As one investor representative commented:

> *There is comparatively limited scope because we're really talking about a product which is underpinned very definitely by regulatory requirements, legal expectations and so on. I don't think it's really possible to say "we'll develop a completely different model for audit from that of PwC or Ernst and Young". That would be a very strange development to see. (IR)*

Quality improvements are likely to be in incremental steps and if, as one audit partner suggested, clients are satisfied with a minimalist approach and are unwilling to pay for (even) higher quality work when they are generally satisfied with audit firm performance, there may be little commercial advantage in firms investing in quality improvement mechanisms beyond the regulatory minimum. In that situation developments in audit quality would tend to be a reaction to regulatory pressure.

On the other hand, auditors have a professional responsibility to maintain the highest standards and to constantly raise the bar to meet public expectations:

> *I believe that what really is the key... is the actual professional responsibility of doing a good quality job. That is a whole bundle of things like the sort of people you have doing the work, the kind of ethical structures around the firm, the training of the people who do the work and the tone at the top...These are the drivers of audit quality. (PB)*

The issues identified by this interviewee are some of the key matters dealt with in the AIU reports, the transparency reports and the governance code. As best practice becomes established in these areas, driven by professional firms, regulated by the POB and encouraged by professional bodies, the quality of audit has the potential to improve over time. As one investor representative observed:

> *[Audit quality] is about continually improving things. It's a bit like the corporate governance in companies – you produce more and more in terms of requirements and expectations. It's just vital that those requirements are expressed in a way that is genuinely productive and the benefits exceed the costs... But I think the potential rewards must be worth it because we're talking about audits of companies worth billions of pounds, so it's worth trying. (IR)*

The impact of the reports on perceptions of the profession

There was general agreement that the proposals are of value. The publication of the AIU reports was viewed positively as they give assurance to the community that the work is being properly done. The lack of major problems identified in recent reports may improve perceptions of the quality of the audit process and the transparency and governance disclosures will demonstrate that auditors are interested in promoting awareness and take these matters seriously. One auditing academic saw the publication of AIU reports and transparency reports as an opportunity for the profession to recover some of the prestige he felt it had lost in recent years.

> *I think the damage done to the profession has been quite severe and I think we have to get back to the stage where we are a respected profession that is trusted. (AA)*

At the same time, it was recognised that there are no "silver bullets" and the proposals are only the first steps along the way. Parallels were drawn with the development of the UK Corporate Governance Code. Since 1992 corporate governance codes have gone through a number of iterations and have moved into areas that were not envisaged by Cadbury. Similarly, the present proposals for auditors have the potential to develop to meet the changing needs of the profession and the business community.

I think it's a good start. The transparency and governance reports are likely to evolve as we see the potential for their use and they could develop into something quite meaningful. The AIU reports are helpful in giving comfort to the business community that audit work is, by and large, being done properly and that there are no systemic weaknesses at the heart of the process. Basically there is an increasing tendency towards disclosure, openness and engagement and that must be a good thing. (GR)

However, there appear to be mixed views in the profession about the value of the proposals. While one partner interviewed was enthusiastic about the opportunities afforded by the proposals, another was more ambivalent, but the third regarded them largely as a regulatory cost:

I'm not sure who benefits from all this. (AP)

The success of the proposals also requires commitment from audit committees, institutional investors and auditors to engage in dialogue and there was a lack of enthusiasm for discussion on governance. Audit committee chairs and institutional investors were largely content that quality control systems were in place but did not feel the need to engage with auditors in these areas.

It's inevitable that people want that security. Not sure that it adds value. Does it give real security? It's an intangible thing. It's more the fact that there is a system. You're going to be asked questions on it so you've got to think your way through. (AC)

Similar views were expressed by a professional body representative and an institutional investor thought there was too much detail in the reports.

Who is going to actually use this information? To what extent will it be used by the people actually appointing the audit firms? You would like to think it will be, otherwise it's a bit of a waste of time. (IR)

In summary, perceptions of the impact of these reports were still being formulated but initial views were that they may encourage continuous marginal improvements as firms learn from each other and bring standards up to best practice. The success of the AFGC initiatives will depend on the commitment of time and resources of audit firms to develop an environment of continuous improvement. However, if all this is viewed as a regulatory cost and any benefit is simply derived from the existence of the reports, rather than their detailed content, it could be an unnecessarily expensive exercise.

7. Key conclusions and recommendations

The objective of the project is to provide evidence on the success of recent initiatives with the publication of AIU reports and transparency reports, and the audit firm governance code, with a view to providing constructive input into future policy direction for both the Financial Reporting Council and the accountancy bodies.

The key conclusions from this project were:

Interactions between stakeholders in the audit and external auditors

- Audit committees were increasingly engaging with auditors on performance but less so on governance. AIU reports were likely to be used more in the future for this.
- Institutional investors preferred to engage with the audit committee but there was little appetite for engagement on audit firm governance.
- The role of the audit committee was seen as key. Both auditors and institutional investors preferred to engage with the committee and there were calls for the audit committee's report to be strengthened to include an appraisal of the auditors.

The role of professional bodies and regulators

- The FRC should take a lead role, through the POB, for monitoring quality of firm reporting.
- Professional bodies saw themselves in a more supporting role, encouraging high quality reporting but not monitoring it.

The impact on audit quality

- Audit quality was perceived as generally good in the UK but a number of interviewees suggested that this needed to filter down below the larger firms.
- It was thought that there would be gradual improvements across the board as there was a shift to a "highest common denominator".
- AIU reports were thought to have a marginal effect on audit quality but perhaps a greater impact on the quality of audit recording and evidence.
- Transparency reports and governance reporting were generally not thought to have an impact on audit quality.

Overall impact of the initiatives

- There was general agreement that the initiatives were of value but were not the "final solution". They require to be continually developed so that continuous improvement will raise expectations, requirements and performance.
- Parallels were drawn with the UK Corporate Governance Code, which has gone through a number of iterations and has gradually improved the quality of UK corporate governance.
- The AFGC proposals, it was thought, have the potential to improve engagement between

auditors and all stakeholders but this will require commitment from all parties. There was considerable doubt as to whether investors, particularly, would see any incentives to engage directly with audit firms.

The way forward – recommendations

Financial Reporting Council

There is a need for a clearer enunciation of the purpose of the transparency reports and the audit firm governance code, particularly as to whether they are intended for firm promotional and differentiation purposes.

There were concerns that some AIU reports were ambiguously worded and that the time invested by firms was out of proportion to the quality of the report issued. We recommend that the AIU works towards improving report quality or reducing firm time commitments.

Professional Bodies

Professional bodies do not consider themselves to have a significant role with publicly available AIU reports or transparency reports; nor do they have specific duties or obligations in relation to these reports. We recommend that the professional accountancy bodies should consider whether this is sufficient or needs to be expanded upon, and whether current practice is a disjointed approach to collective responsibilities to promote audit quality.

Institutional investors

We recommend that institutional investors should have more engagement with audit firms on firm governance and on the firm's audit approach, which could result in greater appreciation of mutual needs and lead to better understanding of the scope, effectiveness and limitations of the audit.

Audit committee chairs

Audit committees are increasingly engaging with their auditors on company-specific matters but we recommend that they should take a greater interest in AIU firm reports and transparency reports as they have a duty to shareholders to ensure that the audit firm selected is an appropriate one for the company.

Audit firms

We recommend that audit firms should engage more proactively with audit committees on governance issues, and in discussing AIU firm reports and transparency reports.

Joint initiatives – the FRC and the professional bodies

Some interviewees, from all stakeholder groups, thought that increasing engagement between the groups was likely to develop over the next few years and could form the basis for the evolution of the audit process and the improvement of auditor governance and transparency. They also expressed an interest in participating in this development. We therefore recommend that focus groups should be set up with interested stakeholders to explore ways in which interactions between auditors, institutional investors and audit committees could develop.

The role of the audit committee was seen as key with both auditors and institutional investors preferring to engage with the audit committee. We recommend that guidance on the role of the audit committee in engaging with investors and evaluating audit quality and governance should be issued.

Both the POB and the professional bodies have roles in encouraging high quality audit work. In order to provide consistency in best practice recommendations we recommend building on current arrangements that the monitoring teams from the professional bodies should meet with the AIU on an annual basis to discuss themes coming out of monitoring inspections and reports. This should be used to inform action by both the regulatory and the education and training functions to assist in raising the quality of audit.

Some auditors did not see benefits in the AIU process or the transparency and governance arrangements, so there is a need to educate auditors on the intended benefits, in terms of improved audit quality, rigour of the audit process, and the quality and transparency of audit firm governance.

Key Interview Questions

Audit committee chairmen of listed companies

- To what extent does the audit committee chairman, and the audit committee, carry out reviews of the performance and governance of their external auditors?
- Do interviewees want to know more about their external auditors? If so, what and why?
- To what extent are interviewees aware of the existence and content of:
  - Material published by the AIU (The Audit Inspection Unit), including:
    - ◊ An annual overview report,
    - ◊ Individual public reports on each of the larger audit firms that audit public interest entities, and
    - ◊ reports on individual audits reviewed by the AIU.
  - Other material including:
    - ◊ A transparency report, which is a statutory annual requirement and produced by each of the larger audit firms, and
    - ◊ An Audit Firm Governance Code, a best practice report recommended for financial years commencing on or after 1 June 2010.
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do/would the interviewees find most and least useful?
- What additional information would interviewees like to see disclosed in the three reports?
- Does the audit committee chairman have feedback mechanisms concerning audit quality to:
  - the audit firm (eg with the audit partner and/or via the audit firm's independent non-executives) and
  - other interested parties such as the institutional investors.

Institutional investors and investor representative groups

Review of audit firms:

- To what extent do interviewees carry out reviews of the performance and governance of the external auditors of their investee companies?
- Do interviewees want to know more about their investee companies' external auditors? If so, what and why?
- Do the institutional investors have feedback mechanisms concerning audit quality to:
  - the audit firm (eg with audit firm's partners and/or via the audit firm's independent non-executives) and
  - with the audit committee chairman, or chairman, of investee companies?

Use of audit quality reports:

- To what extent are interviewees aware of the existence and content of:
  - Material published by the AIU (The Audit Inspection Unit), including:
    - ◊ An annual overview report,
    - ◊ Individual public reports on each of the larger audit firms that audit public interest entities, and
    - ◊ reports on individual audits reviewed by the AIU.
  - Other material including:
    - ◊ A transparency report, which is a statutory annual requirement and produced by each of the larger audit firms, and
    - ◊ An Audit Firm Governance Code, a best practice report recommended for financial years commencing on or after 1 June 2010.
- How do institutional investors use AIU reports and other reports?
- Do the AIU reports, and/or other reports, lead to institutional investors differentiating between audit firms?
- Are they written in an appropriate style?
- What impact do interviewees think the reports will have on auditing in the UK?
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do/would the interviewees find most and least useful?
- What additional information would interviewees like to see disclosed in the three reports?

CCAB Bodies

The role of CCAB bodies in relation to AIU reports, transparency reports, and AFGC reports:

- Do the professional bodies have a duty to raise awareness of the reports and/or their use? If so, to what extent do interviewees encourage non-executive directors of listed companies and institutional investors to review the performance and governance of their external auditors?
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do the interviewees consider would be most and least useful to non-executive directors and institutional investors?
- What additional information would interviewees like to see disclosed in the three reports?

How do the AIU reports interface with the body's monitoring and reporting?

(Note: the AIU reports that are sent directly to the ARC committees are not relevant to this survey/interview, which seeks to establish the use of information re audit quality amongst audit customers and other stakeholders.)

- To what extent do interviewees anticipate monitoring the quality of the three reports and the responses of the business community to them?

In relation to both of the above:

- Are AIU reports and transparency reports valuable?
- What do you do with them?
- What else do you want to see in them?
- What impact do interviewees think the reports will have on auditing in the UK?

Government and regulators

Policy objectives:

- To what extent is the interviewee aware of the different reports and their content?
- What are the policy objectives that underlie the introduction of each type of report?
- Does the interviewee consider that the implementation of each report has met its policy objectives?
- To what extent do interviewees anticipate monitoring the quality of the three reports and the responses of the business community to them?

Promoting policy objectives and awareness of the various reports:

- To what extent do interviewees encourage non-executive directors of listed companies and institutional investors to review the performance and governance of their external auditors?
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do the interviewees consider would be most and least useful to non-executive directors and institutional investors?

- What do interviewees consider would be the most appropriate feedback mechanisms to the audit firms and other interested parties by non-executive directors and institutional investors on the three reports?
- What impact do interviewees think the reports will have on auditing in the UK?

Partners in audit firms

The audit inspection process:

- How time consuming was the audit inspection?
- What level of resources did this involve?
- Was this considered to be proportionate?
- Was the process considered to be fair?
- What value/benefits did the auditor concerned derive from the process?
- What information did the audit firm give to their audit clients in relation to the different types of audit reports and transparency reports?

Use of AIU reports, transparency reports and AFGC reports:

- To what extent do interviewees support the proposals for non-executive directors of listed companies and institutional investors to review the performance and governance of their external auditors?
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do the interviewees consider would be most and least useful to non-executive directors and institutional investors?
- What additional information would interviewees like to see in the three reports?
- What do interviewees consider would be the most appropriate feedback mechanisms to the audit firms and other interested parties by non-executive directors and institutional investors on the three reports?
- What impact do interviewees think the reports will have on auditing in the UK?

Academics and research organisations

- To what extent do interviewees support the proposals for non-executive directors of listed companies and institutional investors to review the performance and governance of their external auditors?
- To what extent are interviewees aware of the existence and content of:

  - Material published by the AIU (The Audit Inspection Unit), including:

    ◊ An annual overview report,

    ◊ Individual public reports on each of the larger audit firms that audit public interest entities, and

    ◊ reports on individual audits reviewed by the AIU.

- Other material including:
    - ◊ A transparency report, which is a statutory annual requirement and produced by each of the larger audit firms, and
    - ◊ An Audit Firm Governance Code, a best practice report recommended for financial years commencing on or after 1 June 2010.
- Which aspects of the AIU and Transparency reports and the disclosures proposed by the AFGC do the interviewees think would be most and least useful to non-executive directors and institutional investors?
- What additional information would interviewees like to see in the three reports?
- What do interviewees consider would be the most appropriate feedback mechanisms to the audit firms and other interested parties by non-executive directors and institutional investors on the three reports?
- What impact do interviewees think the reports will have on auditing in the UK?

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