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Dear Mr Grant

APB discussion paper ‘Auditor Scepticism: Raising the Bar’

We welcome the opportunity to comment on the above discussion paper. The application and interpretation of professional scepticism is a critical component of an audit. Given the fact that concerns have been raised by regulators, we believe it is appropriate for there to be a debate about what professional scepticism means in the current accounting and auditing environment.

The discussion paper refers to the AIU’s concern that “*audit firms sometimes approach the audit of highly judgmental balances by seeking to obtain evidence that corroborates, rather than challenges, the judgments made by their clients*”, specifically “*relating to fair values and the impairment of goodwill and other intangibles and future cash flows relevant to the consideration of going concern*”. It is important to clarify what the auditor’s role is in ‘*challenging the judgements made by the client*’:

- As established by ISAs, the objective of challenging management’s assertions is to corroborate them; that is to ensure that they are backed with evidence that is appropriate, supportable and capable of independent verification. Consequently, challenge and corroboration are not mutually exclusive.
- It is not the auditor’s job to develop alternative views and then try to persuade management to adopt them in preference to theirs. The Companies Act requires that financial statements show a true and fair view. In areas of uncertainty, it is quite possible for different people to legitimately reach different conclusions on the same issues.
- In practice, the application of scepticism is broad ranging and pervades the whole audit process. Often management will consult with the auditor in the course of making decisions. An auditor may exercise professional scepticism at that stage to influence management to take a different position. Therefore, persuasion and influence play a very important part. Excessive confrontation, however, has severe limitations.
- International Financial Reporting Standards do not allow a bias of ‘prudence’. When measuring impairment of financial assets they also do not allow conditions expected to occur after the balance sheet date to be taken into account. Therefore, auditors cannot require their clients to adopt the most prudent valuation or book all expected future declines in value because the accounts need to properly apply the accounting standards. This is not evidence of the auditor failing to be sufficiently sceptical.

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Professional scepticism is defined in auditing standards as “*an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.*” Whilst practical application of this requirement is judgemental and will vary according to circumstance, it is hard to evidence. Scepticism is inevitably applied in real time and is a cultural and behavioural issue. To establish and reinforce the culture of scepticism, we have a robust system of internal quality control, including training, consultation and on the job coaching and review. It is our experience that in the majority of cases audits lead to changes in financial statements prior to issuance.

Our belief is that professional scepticism is applied consistently and rigorously in most audits. The evidence presented in the discussion paper does not indicate that professional scepticism has not been applied. The evidence derives in the main from regulatory reviews of audits undertaken after the work has been concluded and by reference to the documentation on the audit file. Audit files record the audit evidence supporting the auditor’s final conclusions – they are not a detailed chronological account of the way in which these conclusions came about. As such, it will always be difficult to determine the level of professional scepticism actually applied merely by reviewing audit files. However, we acknowledge the importance of independent oversight and we would therefore be interested to explore ways of better evidencing the level of professional scepticism being applied without creating additional audit procedures or unnecessary documentation.

We recognise that the audit process is often opaque to shareholders, making it difficult for them to understand significant judgements made in an audit and therefore whether the auditor has applied professional scepticism. We believe that it is essential that the audit process is made more transparent; we are currently discussing with the audit committee chairmen of our major clients how audit committees could disclose more details in the annual report about their dialogue with external auditors, in particular in relation to the risks of misstatement and areas of judgement.

We have significant concerns with some of the other assertions being made in the discussion paper which are set out in the appendices. In particular:

- We believe clarity ISAs reflect a ‘neutral’ rather than the ‘presumptive doubt’ approach suggested in the discussion paper.
- The majority of the referenced research is either pre-Enron or US based and therefore not directly linked to current practices in the UK.

We include in appendix 1 our responses to the specific questions posed in the discussion paper and in appendix 2 other detailed comments on matters covered in the discussion paper.

We would be happy to discuss our comments further. Please contact Richard Sexton or Chris Taylor should you wish to discuss or clarify any matter in this response.

Yours sincerely

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP

Appendix 1: Responses to specific questions

1. Do you agree with the emphasis that this paper places on the importance of auditor scepticism? Are there aspects of the analysis, including the summary of academic research in Appendix 1, with which you particularly agree, or disagree? If so, what are they?

We agree that the application and interpretation of professional scepticism is a critical component of an audit. Given the fact that concerns have been raised by regulators, we believe it is appropriate for there to be a debate about what professional scepticism means in the current accounting and auditing environment. The AIU observations included in the discussion paper refer to professional scepticism as *'challenging the judgements made by the client'*. It is important to clarify what the auditor's role is as set out in our response to question 2.

Professional scepticism is defined in auditing standards as *"an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence."*¹ Whilst practical application of this requirement is judgemental and will vary according to circumstance, it is hard to evidence. Scepticism is inevitably applied in real time and is a cultural and behavioural issue. To establish and reinforce the culture of scepticism, we have a robust system of internal quality control, including training, consultation procedures and on the job coaching and review. We believe that this is working. It is our experience that in the majority of cases audits lead to changes in financial statements prior to issuance.

Our belief is that professional scepticism is applied consistently and rigorously in most audits. The evidence presented in the discussion paper does not indicate that professional scepticism is not being applied now:

- Since the collapse of Enron many changes have been made to the regulatory environment of the audit profession which we believe have contributed to enhanced audit quality. These include the adoption of international auditing standards ('ISAs'), the international standard on quality control, the APB's ethical standards and increased regulatory oversight over the audit profession. This is not recognised in the discussion paper as it references the following findings: APB's discussion papers 'Fraud and audit - choices for society' and 'Aggressive earnings management'; disciplinary investigations; SEC fraud related cases (in itself a biased population as it relates to cases where the auditor was deemed fraudulent) and the US Panel on Audit Effectiveness². The majority of the referenced research is either pre-Enron or US based and therefore not directly linked to current practices in the UK.
- The recent evidence presented in the discussion paper derives, in the main, from regulatory reviews of audits undertaken after the work has been concluded and by reference to the documentation on the audit file. Audit files record the audit evidence supporting the auditor's final conclusions – they are not a detailed chronological account of the way in which these conclusions came about. As such, it will always be difficult to determine the level of professional scepticism actually applied merely by reviewing audit files.

¹ Definition of professional scepticism in ISA 200, para 13(l)

² Pages 9 and 10 of the discussion paper.

The discussion paper does not fully represent the way professional scepticism is dealt with in the International Standards on Auditing (UK & Ireland):

- We agree with the discussion paper³ that “*greater doubt is not unambiguously a good thing as it may lead to unnecessary procedures, over-auditing and inefficiency*”. But, we disagree with the discussion paper’s assertion that the clarity ISAs can be characterised as reflecting a ‘presumptive doubt’ approach in terms of the initial mindset of the auditor. The discussion paper³ describes ‘presumptive doubt’ as a mindset “*where the auditor exhibits a heightened awareness of the risk that the figures could be affected by error or dishonesty*”, and contrasts it with a ‘neutral’ mindset “*in which the auditor neither accepts management figures and explanations in an unquestioning way nor assumes that there is error or misstatement*”.

The term ‘presumptive doubt’ is not used in the ISAs. Having an initial mindset of ‘presumptive doubt’ as expressed in the discussion paper reflects an approach that assumes management is dishonest. This would result in procedures far beyond a ‘questioning mind’ as set out in the ISA definition of professional scepticism and the established concept of an ‘enquiring mind’⁴. It would also be contrary to the risk-based approach recently re-emphasised by the clarity ISAs for the auditor to have a ‘presumptive doubt’ approach in all circumstances. The auditor starts from a ‘neutral’ mindset and, based on a robust understanding of the entity and its environment, performs a risk assessment to determine the level of evidence needed to respond to the assessed risk of material misstatement. For significant risks of material misstatement the ISAs require the auditor to perform additional procedures.

- The clarity ISAs re-emphasise the importance of professional scepticism when planning and performing the audit⁵ and in key areas such as the audit of accounting estimates and fair values. In addition there are many requirements in ISAs where professional scepticism is the underlying reason for the requirement without using the term ‘professional scepticism’. Appendix 2 ‘*References to scepticism in ISAs (UK & Ireland)*’ lists only those instances where the term ‘professional scepticism’ is used. It therefore does not provide the full picture of how professional scepticism is addressed in the clarity ISAs.
- We do not believe there is a need to require anything beyond what is included in clarity ISAs on professional scepticism, either in terms of documentation requirements or additional procedures. The clarity ISAs are effective for December 2010 year-end audits and there should not be further requirements or guidance until their effectiveness has been assessed, for instance through performing research in a clarity ISA environment. Increased prescription in this area may also detract from applying professional scepticism (see our response to the question on disincentives). In addition, any further ISA requirements or guidance should be discussed with the IAASB to recognise that a consistent global approach should be maintained on matters relating to auditing standards. Increased prescription in the UK alone would move the UK out of line with international practice and potentially threaten the competitiveness of the UK and increase the cost of the audit.

We have significant concerns with some of the possible disincentives to auditor scepticism noted in the discussion paper and these are included in Appendix 2 to this letter.

³ Page 21

⁴ Lord Denning’s ‘enquiring mind’ test referred to in footnote 6 of the discussion paper

⁵ ISA 200, paragraph 15

2. Regulators have recently challenged audit firms on whether sufficient scepticism was demonstrated on some audits:

▪ Do you think that this problem is widespread or limited to certain types of audits or circumstances?

The evidence presented does not indicate that professional scepticism has not been applied as set out in our response to question 1. In terms of regulators' comments, the APB discussion paper notes in paragraph 1 that *"in the wake of the banking crisis, regulators have challenged audit firms on whether sufficient scepticism was demonstrated and the need for audit firms to exercise greater professional scepticism was a key message in the Audit Inspection Unit (AIU) 2009/10 Annual Report"*.

In terms of audits of banks, discussion paper DP 10/3 issued by the FSA and FRC – *'Enhancing the auditor's contribution to prudential regulation'* raised certain matters in relation to professional scepticism on bank audits. We have responded separately to that discussion paper. The application of professional scepticism applies to all UK audits and not just to those regulated by the FSA. Therefore, the comments made in our response to this APB discussion paper apply to all UK audits, including bank audits.

The discussion paper⁶ refers to the AIU's observation that *"audit firms sometimes approach the audit of highly judgmental balances by seeking to obtain evidence that corroborates, rather than challenges, the judgments made by their clients"*, specifically *"in relation to fair values and the impairment of goodwill and other intangibles and future cash flows relevant to the consideration of going concern"*.

It is important to clarify what the auditor's role is in *'challenging the judgements made by the client'*. We have the following observations on this:

Valuations

- The Companies Act requires that the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, not the true and fair view. In areas of uncertainty, it is quite possible for different people to legitimately reach different conclusions on the same issues.
- As the reporting model increasingly moves from historical cost to valuation, it is important to recognise that there is often not a precise answer but a range of valuations. Valuation is a matter of judgement. In order to test that judgement, the auditor needs to consider it with respect to available evidence that supports the valuation put forward by management. In an active market there is a significant body of available reference data and a significant consensus on the valuation. In an illiquid market, there is uncertainty as there is less reference data which will show a wider range of valuations.

An example is the valuation of properties by estate agents: for an apartment in a popular residential block in the city there will be a lot of reference data and the valuations put forward by different estate agents will be close to each other; for a house located remotely the valuations will show a wider range as there is less market movement and therefore less reference data to support the valuation.

⁶ Page 10.

Therefore, when different companies recognise a wide range of valuations for the same products in an illiquid market, then this could be the result of the high level of uncertainty inherent in an illiquid market rather than auditors not applying professional scepticism. If auditors were to ask all companies to apply the same assumptions in their valuations then this would imply that the auditor has better knowledge than the market and the client.

- International Financial Reporting Standards do not allow the application of a bias of 'prudence'. Therefore, auditors cannot require their clients to adopt the most prudent valuation because the accounts need to properly apply the requirements of accounting standards. This is not evidence of the auditor failing to be sufficiently sceptical. Prudence can also be used to justify smoothing of results.

The auditors' role on valuations

- As established by ISAs, the objective of challenging management's assertions is to corroborate them; that is to ensure that they are backed with evidence that is appropriate, supportable and capable of independent verification. Consequently, challenge and corroboration are not mutually exclusive.
- It is not the auditor's job to develop alternative views and then try to persuade management to adopt them in preference to theirs. By prescribing alternative valuations to management when management's valuation is acceptable and fully supported by adequate evidence, the company is adopting the valuation of the auditor which challenges auditor independence.
- In practice, the application of scepticism is broad ranging and pervades the whole audit process. Often management will consult with the auditor in the course of making decisions. An auditor may exercise professional scepticism at that stage to influence management to take a different position. Therefore, persuasion and influence play a very important part. Excessive confrontation, however, has severe limitations.

Using hindsight

- As regulatory reviews of audits are undertaken after the work has been concluded and by reference to the documentation on the audit file, it will always be difficult for regulators to determine the level of professional scepticism actually applied. This is amplified by using hindsight only available at the time of the inspection and not available at the time of the audit, for example markets falling after the audit opinion date. By the time the audit is inspected these events may make judgements made at the time of the audit seem less valid; however this does not mean the auditor did not apply professional scepticism.
- In addition, International Financial Reporting Standards require application of the incurred loss model when impairing financial assets; this means that losses booked reflect economic conditions at the balance sheet date. When there is a deterioration to these conditions after the balance sheet date additional losses will only be recorded when a loss event is considered to have occurred at the balance sheet date. Therefore, auditors cannot require their clients to book all expected future declines in value because the accounts need to properly apply the accounting standards. This is not evidence of the auditor failing to be sufficiently sceptical. Further losses booked at a later date reflect market conditions at that later date as required by accounting standards. We note that the IASB is currently considering changes to the accounting standards in this area.



▪ **What factors do you believe do, or could, in practice create disincentives for auditors to apply an appropriate degree of professional scepticism and what should be done about them?**

A move away from principles to rules would demotivate audit staff and would therefore create a disincentive to apply professional scepticism.

We believe that the best audits are performed by bright and intelligent people. To motivate staff and remain attractive to highly intelligent professionals, the audit needs to be flexible to allow auditors to apply their professional judgement and scepticism to tailor the audit approach to varying circumstances and to allow auditors to pursue their own enquiries. The risk based approach in (clarity) ISAs and our audit methodology and systems allow for this flexible approach.

Appendix 2 to our response states that increased complexity of IFRS, increased mandatory procedures in auditing standards and the inspection regime has led to increased time spent on documenting compliance and to a system increasingly driven by rules and box ticking. A further move to a rules based approach (including having increased prescription on professional scepticism) would result in even more box ticking and would detract from focussing on professional scepticism. ISAs should therefore remain principles based to allow for a flexible audit approach as described above.

We have significant concerns with some of the possible disincentives to auditor scepticism noted in the discussion paper and these are included in Appendix 2 to this letter.

▪ **In what areas do you think auditors should be more (or less) sceptical in their approach?**

Professional scepticism permeates the audit and should always be applied when performing an audit. It would therefore be inappropriate to prescribe areas where auditors should be more (or less) sceptical. We believe that clarity ISAs already sufficiently emphasise scepticism and a risk-based approach to auditing. As set out in our response to question 1, we do not believe there is a need to require anything beyond what is included in clarity ISAs on professional scepticism, either in terms of documentation requirements or additional procedures.

As set out in our response to question 1, audit files record the audit evidence supporting the auditor's final conclusions; they are not a detailed chronological account of the way in which these conclusions came about. As such, it will always be difficult for regulators to determine the level of professional scepticism actually applied merely by reviewing audit files. However, we acknowledge the importance of independent oversight and we would therefore be interested to explore ways of better evidencing the level of professional scepticism being applied without creating additional audit procedures or unnecessary documentation.

3. How do you think audit firms should promote and develop professional scepticism in their partners and staff? Do they need to do more and, if so, what?

As set out above, professional scepticism is applied in real time and is a cultural and behavioural issue. It is also an important element of audit quality. We therefore establish and continually reinforce scepticism through the culture of the firm and quality control procedures, including: on the job coaching and review, the quality evaluation programme, quality key performance indicators, consultation policies, quarterly quality in practice webcasts and an internal training curriculum providing a broad range of technical solutions, industry, business and personal skills programmes. These and our other quality control procedures are described in more detail in our transparency report available on our website⁷.

As set out in our response to question 2, persuasion and influence also play a very important part. The auditor therefore needs to demonstrate strong influencing skills and this is covered in our training curriculum. Our appraisal and rewards systems also reward people for applying professional scepticism both in terms of influencing the client and also in terms of standing our ground in disagreements with the client.

4. Do you think that others, including companies, should be doing more to promote, develop and support professional scepticism in auditors? If so, what?

We believe there is a role for audit committees and investors to promote open debate between management and the external auditors.

Good corporate governance includes audit committees acting independently from management to ensure the interests of the shareholders are properly protected in relation to financial reporting. As part of this, audit committees must be prepared to take a robust stand, listen to views and talk through issues openly. This includes audit committees considering significant financial reporting judgements and estimates taking into account the views of management and the auditor. In our experience, some audit committees encourage debate between management and the auditors by taking a balanced view when different opinions are put forward. However we also see audit committees who feel it is their responsibility to support management's positions which therefore hampers debate. More guidance for audit committees on how to deal with differing views between management and the auditor in a way that is balanced and encourages debate may help in this. Investors could also be encouraged to challenge audit committees on their debate with the external auditor.

We recognise that the audit process is often opaque to shareholders, making it difficult for them to understand significant judgements made in an audit and therefore whether the auditor has applied professional scepticism. We believe that it is essential that the audit process is made more transparent; we are currently discussing with the audit committee chairmen of our major clients how audit committees could disclose more details in the annual report about their dialogue with external auditors, in particular in relation to the risks of misstatement and areas of judgement.

Our comments on some of the other actions suggested in the discussion paper are included in Appendix 2.

⁷ http://www.pwc.co.uk/annualreport10/transparency_report.html

Appendix 2 – Other detailed comments on matters covered in the discussion paper

A. Possible disincentives to auditor scepticism

We have significant concerns with the following possible disincentives to auditor scepticism noted in the discussion paper:

Relationship management and short term profitability (paragraphs 27 and 29)

Paragraph 27 of the discussion paper notes that the audit firms' focus on relationship management may be a disincentive to scepticism as by demonstrating scepticism they risk having an 'unhappy client'. This assertion disregards current client feedback and the current regulatory environment as noted in our response to question 1. In our experience audit clients welcome and expect a robust audit that involves professional scepticism. A focus on relationships is essential to have an open dialogue with management throughout the audit, encouraging debate on judgemental areas, so that the auditor can influence management appropriately.

Paragraph 29 notes that application of scepticism can also directly threaten short term profitability as fees are agreed in advance and that negotiating overruns can adversely impact client relationships. In our experience, audit clients understand that we may need to perform additional audit work and are used to the practice of auditors seeking to recover cost overruns. Engagement letters often include wording to address the possibility of overruns. In addition the risks to the auditors of reputational damage and exposure to litigation are of greater concern than short term profitability.

Paragraph 28 notes delays caused by the auditor pursuing additional inquiries that cause the audit not to be completed by the agreed date. In our experience this rarely happens. Auditors identify significant risk areas as part of audit planning and perform the audit of these areas earlier in the audit process to allow sufficient time to obtain audit evidence.

Client co-operation arrangements (paragraphs 44 and 45)

The discussion paper implies that requesting the client to prepare, in advance of the audit, specific schedules and analyses may make auditors over-trusting and reduce scepticism being applied.

Client co-operation arrangements are common practice as they ensure the audit runs efficiently and effectively. Obviously such arrangements should not allow client management to influence the extent and nature of the audit work performed. As noted in our response to question 2, the auditor's role is to audit management's assertions in order to ensure that they are backed with appropriate evidence. It is not the auditor's job to develop alternative views and then try to persuade management to adopt them in preference to theirs. It is therefore entirely appropriate to request management to prepare analyses that support the judgements they have made. We do not take them at face value, we corroborate the information. They enable the auditor to focus on gathering audit evidence rather than producing schedules.

New staff level auditors and junior staff (paragraphs 10, 29, page 25 and 26)

Paragraph 10 states: “*some academic research suggests that new staff level auditors demonstrate significantly higher levels of sceptical thought and action than their superiors*”. The discussion paper references this to research performed in the US in 1999.

Other research (see page 25 of the discussion paper) and our experience show that although new auditors display curiosity and a questioning mind, they do not necessarily display the other characteristics from the Hurtt Model⁸ that are also needed to have professional scepticism: not jumping to premature conclusions, understanding management behaviour and motivations, self-confidence and self-determination. Curiosity and a questioning mind are necessary for new auditors as they need to learn auditing procedures. The other characteristics however are acquired and enhanced through experience and together with a questioning mind ensure questions are asked in the appropriate areas.

Paragraph 29 states “*Keeping to the plan is also a plausible strategy for junior staff who are already working long hours and may not wish to work even longer*”. The related footnote 16 refers to a survey dating back to the 1990s and research in Ireland published in 2004. It is therefore not based on current practice in the UK and also ignores the safeguards of internal quality control procedures such as on the job coaching and review (as noted in paragraph 35 of the discussion paper).

Computerised audit methodologies (paragraphs 40 and 46)

We are confused by the emphasis on computerised audit methodologies as we do not consider that the medium of delivery of methodology or the effect of the use of IT is particularly relevant to the debate on professional scepticism. We accept the point being made about time spent in the audit room (paragraph 40) but feel that this is driven by other factors, for example, increasing complexity of IFRS, increasing documentation procedures in auditing standards and the inspection regime. Regulators have to be able to review audits after the work has been concluded. They do this by reference to documentation on the audit file as evidence of compliance with mandatory procedures in auditing standards. This therefore requires auditors to spend more time documenting compliance, which has therefore made the system increasingly driven by rules and box ticking. This is also recognised by research performed by V. Beattie, S. Fearnley and T. Hines into factors affecting audit quality in the 2007 regulatory environment⁹.

It is therefore important that audit methodologies are flexible to allow auditors to apply their professional judgement and scepticism to tailor the audit approach to varying circumstances and to encourage auditors to pursue their own enquiries. Paragraph 46 suggests audit firms should take stock of the progress made in automation of their systems. We have already done this and as a result are currently implementing a new audit system to further allow for this flexible approach and therefore further improve the quality and value of our audits.

⁸ The Hurtt Model is discussed on page 21 of the discussion paper.

⁹ This research is referred to by the authors in their written submission to the House of Lords Economics Affairs Committee inquiry *Auditors: market concentration and their role* – available at <http://www.parliament.uk/documents/lords-committees/economic-affairs/auditors/auditorswe1.pdf>

B. Further action

We have the following comments on some of the actions suggested in the discussion paper.

Sharing of war stories (paragraph 53)

Our training includes sharing of war stories. We agree with the suggestion in paragraph 53 of the discussion paper that it may be beneficial for the APB, or another body, to publish lessons learnt, recognising that this is not always easy to do within the constraints of client confidentiality.

Further action on auditing standards or APB guidance (paragraph 50 to 52)

Paragraph 50 to 52 of the discussion paper suggest adding certain further requirements to ISAs or the APB developing further guidance on professional scepticism. As set out in our response to question 1, the clarity ISAs re-emphasise the importance of professional scepticism. We therefore believe that there should not be increased prescription in this area until their effectiveness has been assessed.

In terms of the matters suggested in paragraph 50 to be added to ISAs we note the following:

- We do not understand the basis for the statement “*consideration could be given to whether Auditing Standards inadvertently lead auditors to place undue reliance on management’s work*”. Our response to question 2 discusses the auditor’s role.
- Some matters are already covered in ISAs:
 - ISA (UK&I) 230 requires documentation of significant matters and the related guidance material states that this may be by way of a summary memorandum that describes how significant matters identified in the audit have been addressed.
 - ISA (UK&I) 220 requires that the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that appropriate audit evidence has been obtained.
- We do not believe that retention of review notes will lead to more scepticism being applied. Written schedules of review notes have not been common on audit files for over a decade. It is also contrary to the suggestion that reviews should be undertaken in person, which means less written review notes being made.
- Although we agree that for highly judgemental areas review in person is preferable, mandating that reviews are undertaken in person would be (i) difficult to demonstrate compliance with and (ii) impractical as occasionally it is more effective to perform elements of the review over the phone / remotely, especially when the client is located at many different sites.



Further action on APB Ethical Standards (paragraphs 55, 56, 60 and appendix 1 - page 24)

We agree with the discussion paper that ways of avoiding auditors placing too much trust in their clients are addressed by APB Ethical Standards which provide requirements and guidance on maintaining auditor objectivity and independence. Paragraph 55 of the discussion paper suggests prohibition of certain non-audit services and mandatory rotation of audit firms as possible methods to enhance auditor objectivity and independence.

The APB has recently consulted on non-audit services to which we have responded separately. We do not seek to include our comments on the detailed aspects of that consultation here, but in overview we are pleased that the APB has taken into account the overwhelming message from the October 2009 consultation that the threats and safeguards approach to auditor independence is fit for purpose. The threats and safeguards approach has underpinned the UK approach to auditor independence and is widely used internationally.

We believe that mandatory rotation of audit firms would impair audit quality. We agree with paragraph 60 of the discussion paper that there are well documented disadvantages to a requirement for mandatory rotation of audit firms. Ethical Standards require mandatory rotation of the audit engagement partner after 5 years for listed companies; this already goes beyond international ethical standards.