



MONITORING THE WORK OF THIRD COUNTRY AUDITORS

Comments from ACCA
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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

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GENERAL COMMENTS

ACCA welcomes the opportunity to comment on this consultation document, and acknowledges that the requirement to implement a system of monitoring third country auditors represents a significant challenge for the Professional Oversight Board (POB). The consultation document culminates in a comparison between two options for monitoring third country auditors, and given the costs attaching to each alternative system, ACCA favours an approach of monitoring all third country auditors on a cyclical basis.

Nevertheless, the majority of the consultation document considers a more tailored approach, whereby the system of monitoring is risk-based. This approach, which assesses risk of financial loss to investors based on the significance of issuers in a particular country, is appropriate except that it does not consider the risk that an audit opinion is not adequately supported by evidence, or that quality assurance systems in that country are ineffective.

Specifically, the analysis of 'Article 45' third country auditors in Annex A to the consultation document focuses on the significance of the issuers in each country, leading to an assessment of country significance. It takes no account of environmental factors, especially the effectiveness of national quality assurance programmes, which might provide a better risk assessment for each country.

ACCA has members in practice worldwide, and operates an effective monitoring methodology, which has been developed over the last 20 years and is under continuous review and improvement. In many countries, ACCA members and firms are required to register with the national professional body or regulator. Where that body or regulator has a monitoring programme in place, ACCA aims to avoid duplicating that work. However, we undertake audit monitoring on behalf of over a dozen other professional bodies and regulators under contract. (This work is subject to scrutiny by ACCA's Regulatory Board.) In addition, there is a small number of ACCA members that practise in countries that do not have a programme of monitoring, and these members and their firms are subject to direct monitoring by ACCA, which is risk-based.

Therefore, we are in a position to offer a unique perspective. Through its international monitoring arrangements, ACCA has experience of a range of different business cultures, corporate governance arrangements, ethical

standards of behaviour, national quality assurance systems, national audit quality and reliability of international network reviews.

ACCA's report on regulation is available to view at <http://www.accaglobal.com/en/member/professional-standards/regulatory-board/report-regulation.html>

CONSULTATION QUESTIONS

1. Do you agree with the overall approach set out in paragraph 3.2?

Generally, we agree with the overall approach. However, care must be exercised, given the widely differing business cultures and corporate governance standards in different countries. This means that, even where a country's overall significance is assessed as very low, audit failure in respect of a single issuer would have a significant adverse impact on the reputation of the POB scheme.

2. Do you agree with the proposals on "Article 45" auditors set out in paragraph 3.3? If not, what alternative(s) would you propose?

Generally, we can see merit in these proposals, although we have the following (largely cautionary) comments concerning each of the bullet points listed in paragraph 3.3 (numbering them 1 to 6):

Points 1 and 2 – While we believe that these points represent a flexible and proportionate approach, care should be taken if relying on another audit regulator or professional body that operates internationally. It will be necessary for the POB to obtain reliable evidence that the inspections are robust, and that there is a high probability that all significant matters will be identified from the audit file reviews and that the overall conclusions reached are appropriate. We would question whether or not the POB may be in a position to judge that a body has the necessary skills in audit monitoring if the POB has not previously worked with the other regulators concerned.

Point 3 – Clearly, this is a higher risk strategy, as the consultation document makes no reference to the POB assessing the reliability of the local professional body's monitoring processes and procedures. This point does not illustrate how oversight of the local professional body might occur. We also note that this strategy does not appear to take account of the risk environment in each country in which there are issuers of low to medium significance. Although a country's overall significance may be assessed as very low, it is likely that audit failure in respect of a single

issuer would have a significant adverse impact on the reputation of the POB scheme.

Point 4 – The strategy in respect of audit firms registered in both the UK and another member state appears reasonable and proportionate, although lacking detail within the confines of the consultation document.

Point 5 – The intended approach in respect of these low significance issuers appears flexible and, indeed, a flexible attitude is essential in view of the risks concerned with placing a degree of reliance on international network firms' inter-office reviews. However, ACCA has found that the reliability of such reviews within international networks can vary significantly and that some of the major networks are unable to ensure globally consistent standards of audit. If this is accepted, it might therefore be deduced that they cannot provide a globally consistent standards of inter-office review.

Point 6 – At this higher level of significance, direct monitoring by the Audit Inspection Unit (AIU) would be proportionate, although we should note that this targeting of audit firms is based on the size of the issuers in a particular country, and is not based on the risk posed by the local environment. In addition, in the event of an audit failure, the POB could face reputational damage in respect of issuers of some significance in a country considered to be of low overall significance.

Further, we would agree that the degree of assurance obtained by reviewing firm-wide quality control procedures and a single audit file in the case of a firm with five or more audits provides a comparable level of assurance to that obtained by inspecting all audits of relevant issuers in a firm with fewer than five audits.

The proposals in respect of these countries take no account of the practical limitations noted in paragraph 2.9 of the consultation document. These include the possibility that working papers may be in a language other than English. The POB should establish, as soon as possible, the precise extent of this problem in respect of the countries and auditors that fall within this category. As most international issuers will use 'Big Four' audit firms, whose staff understand English, it might be advisable that UK issuers require their auditors to record their work in English. Where this is

not possible, the POB would have to arrange reliable and accurate translations into English.

3. Do you agree with the proposals for “equivalent” registered TCAs, particularly for US audit firms set out in paragraphs 3.5 to 3.7? If not, what alternative(s) would you propose?

In view of the reference, in the third bullet point, to firms being outside the scope of PCAOB, we are not clear whether paragraph 3.7 relates exclusively to US audit firms. To the extent that paragraph 3.7 does relate to US audit firms, we agree with the suggested approach, because the POB has reliable knowledge and experience of PCAOB’s quality assurance procedures and reliability.

With regard to the determination of equivalence generally, the assessments were carried out with the assistance of the European Group of Auditors’ Oversight Bodies (EGAOB), based on principles governing the public oversight, quality assurance, investigation and penalty systems for auditors and audit entities, and the criteria set out in Articles 29, 30 and 32 of the Statutory Audit Directive, which govern the systems for auditors and audit firms of the Member States. The EGAOB’s work was based on publicly available information, including the World Bank Reports on the Observance of Standards and Codes (ROSC), the IFAC Compliance Programme and the IOSCO 2004 Survey on Regulation and Oversight of Auditors, as well as on replies to questionnaires the Commission itself received from third countries’ authorities. It appears that there was little evaluation of the effectiveness of monitoring and the reliability of the monitoring process. Therefore, the POB should be vigilant for signs that might indicate that there are weaknesses in the effectiveness and reliability of audits in ‘equivalent’ third countries and be prepared to take appropriate action in the circumstances.

4. Do you agree that the results of external monitoring should be reported to a regulatory committee of the FRC? (para 3.8)

Yes, we believe that the results of external monitoring should be reported to a regulatory committee for the following reasons:

- i. Decisions concerning the continued registration of a third country auditor (or conditions to be placed on registration) should not be the responsibility of AIU staff.
- ii. To ensure a fair hearing and due process, a regulatory committee and appeals process are essential.
- iii. Referral to a regulatory committee will minimise the likelihood of legal challenges to the process of monitoring third country auditors.
- iv. This would be consistent with the approach adopted for UK auditors, including the processes of the Recognised Supervisory Bodies.

5. What charging structure do you consider provides a sensible and fair basis for recovering the costs of external monitoring? (paras 3.9 to 3.11)

It is important that the charging structure is fair and transparent. The second option has the advantage of offering certainty. However, it would not ensure that those firms and audits that require more attention from the AIU pay more. Therefore, option 1 is preferred.

The transparency of option 1 would make it possible for firms to agree with their relevant issuer clients how they will be reimbursed for the costs of external monitoring (and perhaps the costs of third country auditor registration also).

6. Do you consider that the information we are proposing to publish, as set out in paragraphs 3.12 and 3.13, is adequate for the needs of investors? If not, what do you propose?

Paragraph 3.12 appears slightly ambiguous in stating that 'it is important to provide information ... on relevant reviews of the TCA that have been carried out'. It is unclear whether this means that the results of the reviews of individual audit firms will be published. Care must be exercised when considering whether such publication could,

unreasonably, undermine confidence in the issuer which may be identifiable from the publicity.

While paragraphs 3.12 and 3.13 propose transparency arrangements in respect of the monitoring of third country auditors, we note that the proposals do not extend to the publication of findings and orders of the regulatory committee. We believe that, in most cases, the results of hearings should be published, in the interests of transparency.

We appreciate that there appears to be a conflict between the two paragraphs above. However, the level of information currently appearing in the AIU section of the FRC website in respect of audits of public interest entities appears to reach an appropriate balance.

7. Overall, do you consider that these proposals for external monitoring provide the basis for a proportionate and practicable way of meeting the SAD requirements on quality assurance?

We are concerned that the proposals, taken as a whole, place excessive reliance on the quality assurance procedures and practices in third countries, including those regarded as 'equivalent', without detailed and appropriate evidence to support this reliance. However, subject to this concern, we support the proposals, which we consider reasonable in addressing very difficult circumstances. We welcome the comment in paragraph 3.4 that the POB's approach is likely to be adjusted in the light of experience.

8. Do you have any comments on the assessment of costs and benefits in Section 4? We should welcome in particular the assessment of UK investors on the value of benefits that might flow from the two options for external monitoring reviews.

Option No 1 – We disagree with the implication that the cost per issuer (approximately £9,500 per annum), is material in the context of obtaining and retaining a UK listing.

Option No 2 – We acknowledge that the costs associated with this option are anticipated to be significantly less than option 1. However, option 2 brings with it a significantly higher (some might say an unacceptably high) risk of damage to the POB's regulatory reputation, with a consequential impact on the reputation of the UK's regulatory infrastructure.

Given that we do not consider the cost of option 1 to be excessive, option 1 is ACCA's preferred system of external monitoring.

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