PCAOB public meeting 3 April 2014, panel on recent UK audit reporting experience

Opening remarks by Tony Cates, partner KPMG LLP (UK), panel member

It's probably a good guess that when our UK regulators chose an accelerated timetable for our reform of audit reporting, that was because they wanted the UK experience to be something that others could benefit from. So I'm very happy to be here today and to talk about what we've been doing.

Let me start with why I think that reform is needed.

The catalyst was, obviously, the financial crisis, but perhaps this just brought to the surface an issue that had been around for some time – a decline in shareholders' trust in companies and in audit. Audit should have been playing a key role in creating trust between shareholders and their companies, but it became apparent that it wasn't delivering all that it could. To me as an auditor, the value of an audit is clear, but to the shareholder the binary audit opinion just wasn't delivering it. So I think it was absolutely right that we needed to make a bold move to a long-form audit report; to say what we thought the issues were and what we did about them. After all, audits are for shareholders. So shouldn't we deliver more of the value that comes from our work directly to them?

In terms of putting that into practice, it may be easier for the UK to do that. In UK law our audit reports are for, and addressed to, shareholders as owners only, rather than as traders of shares, using the audited accounts to hold directors to account. That is not necessarily the case elsewhere.

My biggest worry was a short timetable and a short auditing standard – just five paragraphs. However, there was wide recognition that the regulator had laid down a challenge to use those few words to show the value of audit. And with the UK's less fiercely litigious environment, it was easier for us, than perhaps it would be here, to respond to that challenge on the basis of five paragraphs. Essentially we did that by learning "on the job" on our September year-end reports, converting that experience to firm-wide policy and guidance and rolling that out to the firm, with a central team to provide support and a measure of consistency in approach.

So what was the critical deliverable for us? We saw it as the description of our work on the key risk areas. It's this and not, say, materiality figures, that really demonstrates the value of audit, by showing how we brought our experience and independent mindset and scepticism to bear. That demands that we flag the key things that we had to test. So not just that you had to test subjective assumptions in the risk area but specifically which assumptions. And not just that you tested them, but how you applied your outsider's perspective, whether benchmarking against data or against your own views of, say, growth potential of the sector or the client. When we did our KPMG survey of the first movers – only 19 companies had reported by mid-January – this was the area where we found most variety –not surprising for the most difficult aspect of the new UK reporting.

The UK's new reporting, by describing some of our audit procedures, inevitably begs a question: what more can the report say about, for example, what the auditor found in his testing? At

KPMG in the UK we thought that this question shouldn't be left hanging but should be tackled. So, in order to promote a debate about that – about the value and about the challenges – we've tested out the idea in a very small number of reports by also giving the findings of our work on each risk area. That debate has only just started, and I am not here today to promote any kind of position on that; but I do think that as you and your stakeholders debate the way forward for the US, you might want to have one eye on the question of where it could lead.

So back to the existing reporting model in the UK, is it a challenge to do this kind of reporting? Yes. Is it worth doing? Absolutely yes.

But at the same time we should not fool ourselves that better auditor reporting is the answer to preventing future financial crises. It can only ever be part of the solution, and focussing on the adequacy of corporate reporting and corporate governance and stewardship are fundamental pre-requisites without which improved auditor reporting will mean nothing.

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