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Public Company Accounting Oversight Board
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March 26, 2014

Dear Members of the Board

Re: April 2, 2014 Public Meeting on the Auditor's Reporting Model

You have kindly invited me to say a few words at your meeting on the introduction of the new auditor reporting regime in the United Kingdom, from the perspective of a practising audit partner who adopted the reporting early in relation to British Sky Broadcasting plc.

By way of introduction, I am an audit partner in the UK firm of Deloitte and work principally with large listed companies in the TMT and Consumer Goods sectors. I serve on two committees at the ICAEW and also lead Deloitte's Centre for Corporate Governance in the UK, responsible for our points of view on Governance developments and for developing our commentary on the work of the UK's regulator, the Financial Reporting Council (the "FRC").

I would like to touch on three areas:

First, why I believe extended auditor reporting is so important for the future of the profession;

Second, I will share some observations gained from signing in July 2013 one of the first extended audit reports based on the UK's FRC standard, that of British Sky Broadcasting plc; and

Third, based on that experience, I will offer a few observations on what works in the UK and what will be the challenges for the second year.

To start, I need to mention that I would not be participating in your meeting if I were not a big fan of the new audit reporting regime. However, a lot of the success of the regime in the UK is because, at the same time as introducing a new regime for audit reporting, the FRC introduced new requirements for the board to make two statements: (1) that the annual report is fair balanced and understandable; and, (2) that it contains sufficient information to explain the strategy, business model and performance of the company.

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In addition, new requirements have been introduced for the Audit Committee's own reporting to shareholders – namely to examine the scope of the audit and to explain in their report to shareholders the key issues considered for the financial statements and how they were resolved. This quite properly puts the communication responsibility for financial statement judgments on the company rather than the auditor and highlights the role of the Audit Committee in supervising, on behalf of shareholders, the production of the financial statements, the supervision of the scope of the external audit and resolution of the key issues raised on behalf of shareholders.

Second, I also need to make a few introductory remarks about Sky. Sky has a reputation as one of the most successful and innovative companies in the UK, well led by a management with a laser focus on its core mission. In common with many consumer-oriented companies this focus and clarity is reflected in Sky's annual report.

I was very pleased when Andrew Griffith, the CFO, and Martin Gilbert, the Audit Committee chairman, who is also the CEO of Aberdeen Asset Management, a major institutional investor, agreed to take a lead in early adopting both the new audit reporting and adopting as much as possible of the new requirements of the UK corporate governance code.

I will be able to answer some questions at the meeting but of course nothing that might overstep the mark of client confidentiality which I of course ask you all to respect.

So, first, the importance of the new extended audit reporting:

I have been an Audit Partner at Deloitte for some 18 years. We employ about 15,000 people in the UK and last year, into audit alone, we recruited 700 graduates and school leavers: all hugely talented people, most of whom will use their training in audit as a springboard for successful and fulfilling careers in finance and business.

The fact that the key matters we address in our work are now directly described in our public report is inspiring to our people. They are proud to see their work so directly described in a public report. It underscores the public interest nature of our work at a time when the profession is emerging from a rough ride. It invigorates their personal sense of responsibility and pride and underscores to them why quality is so important in everything our audit teams do.

From the perspective of Deloitte UK, we see the extended audit report as an opportunity to inform shareholders about the important work we do on their behalf. We are appointed by shareholders to form a view - and commenting on the major focus areas of our work now seems quite natural, even after just a few months of the new reporting regime.

Speaking as a member of the audit profession as a whole, thanks to the leadership of the FRC and the good work of many others, we have been given the opportunity to re-establish the value of audit. Without becoming too sentimental, we in London are proud of the invention of the accounting and audit profession not much more than a century ago to address issues of integrity with the reporting by managers to shareholders. I believe we should be proud of the moves London is making to help shape the agenda in this area, just as our "comply or explain" governance model is helping to shape shareholder governance regimes elsewhere in the world promoted by the FRC, the ICAEW and the EBRD amongst others. The "comply or explain" model is easy to adopt by reluctant countries and acts as a catalyst to raising standards in a progressive manner.

So what were my experiences of the new extended auditor reporting?

As I said, Sky embraced this from the very first suggestion. The attitude of the company is very much "If we can lead, we will".

The new audit report drives auditors to describe the areas of focus that consume audit effort. The matters we chose to report on - revenue recognition, recognition of programming costs and the validity of capitalisation of capital projects are those that consume audit effort and are areas that are routinely discussed at the Audit Committee – so the topics were already well aired. I would expect that there should be no surprises for management or for the Audit Committee on any of the topics commented on in audit reports. Indeed from my perspective there will have been a breakdown in effective communication if there were surprises at the eleventh hour.

The next question, if the topics are understood and well aired: were the words difficult to find to describe them? This in fact also proved uncontroversial: Sky is hugely respectful of the work of the external auditor and of the reporting we have to make under our professional standards. Because of this we had very little discussion about the choice of words. I believe that companies which are perhaps less respectful will rapidly realise that the auditor's latitude now provides a much more potent voice and I would therefore expect greater respect for the profession and greater engagement with the auditor by management to be one of the positive outcomes from the new regime.

From a personal perspective, I thought the biggest challenge at my door would be to work through how many risks to include in the report and the level of detail in which to describe our audit responses. Also, how these would tie to management's description of the critical judgements set out in the financial statements (which, as you know is a requirement under IFRS) and how these would tie with the Audit Committee's own report to shareholders on judgments and how these were resolved. In fact this mapping exercise was remarkably straightforward, but it does require early engagement with management and the Audit Committee chairman, in particular, to ensure cohesiveness and avoid unnecessary duplication in reporting. This is another benefit from the regime – the early communication and resolution of issues.

I personally have a very strong preference for being succinct. In my view investors have limited time to spend poring over annual reports which tell the story of past events with increasing perfection. They want to get to heart of the matter quickly. I have a strong preference for the "less is more" principle when describing audit risks and responses. So therefore I would encourage a focus on specifics. For example, if goodwill impairment is a risk, then focus on which business it is and what the business issue is that underlies the risk. I am personally not a big fan of long explanations about the audit procedures followed such as saying we verified the mechanical accuracy of the impairment model and all the inputs. I very much prefer to stick to the critical procedures that address the essence of the risk – such as in the case of an impairment in a specific business the difficulty of forecasting in that particular market segment.

We need to remember that we have to look forward to year two and while the new audit report is intriguing and interesting this first year, when we have the same risks in the second, as most companies will tend to, succinctness will be a real blessing for investors. We must remember that the essence of communication is about getting across the key messages.

To summarise, I have mentioned the following as ingredients for success:

1. Early discussion and communication
2. The company's robust governance that deeply respects the role and work of the auditor.
3. Remember the report is about communication with the investors

I was fortunate that Sky is a reasonably straightforward business. The ability of the auditor to report succinctly becomes more of a challenge where the entity is more complex, more geographically dispersed or where there are big judgements to be made or when a business operating model or finances are under strain.

I do strongly believe that coupled with the enhancements to the reporting by the Audit Committee brought in by both the FRC and reinforced by the UK Competition Commission's call for an advisory shareholder vote on the Audit Committee's own report, investors should now be receiving a very useful package which can inform their dialogue with executive management, the chairman and other members of the board.

The more interesting observation perhaps is that this package is published after the preliminary announcement, after the market has moved and after analyst notes are published. I hope that our regulators will review once again the package of information that is delivered to shareholders in the announcement and consider again the opportunity to produce a shortened annual report.

One challenge to be faced by both preparers and auditors in the coming year is the proposed reporting on internal controls. As the FRC turns its attention to the governance and control stewardship aspects, rather than reporting, it has recently consulted on internal controls reporting and we await the final guidance and related changes to our corporate governance code.

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Under the proposed changes, companies will have to report on weaknesses identified in any material controls and remedies implemented. The proposed auditor responsibilities are that auditors need to report if this is not consistent with their knowledge or the description is not fair, balanced and understandable. This will require careful thought.

Turning now to your audit reporting proposals

When considering the proposals, apart from the obvious benefit of seeking international convergence, my early experiences lead me to make five observations:

1. Boiler-plate disclosures in the audit report are public enemy number one. The profession and standard setters should challenge themselves whether they can live without some of the comfort language around "statements of the obvious" that will obscure entity specific material. I wonder if some of the standard verbiage can just be taken to exist under professional standards without actually having to publish it each time?

2. Innovation and company specific tailoring could be stifled by requiring a specific ordering of the report or prescribing standardised language. Comparability can be achieved by a limited number of defined headings, allowing freer form of reporting under each heading. In the UK, we are now seeing wide variety of practice emerging both between firms and between individual partners.

3. In the UK regime we principally describe the areas that take up audit effort and key procedures rather than a conclusion on each key audit matter. I personally like this as our opinion is on the financial statements as a whole and it is really for management and the Audit Committee to explain their judgments. As I mentioned, the communication to shareholders of how issues are resolved is done in the UK via the Audit Committee's report to shareholders. However, it is worth drawing out that we are now seeing some reports in the market where the auditor includes their own commentary on management's judgments. It will be interesting to see how investors react to this – in particular if this is a welcome or perhaps a concerning colouring of the true and fair view.

4. Real care and judgment is needed if there is to be disclosure of audit procedures. I personally would recommend a focus only on those matters that speak to the essence of the risk rather than a long list of audit procedures. As I said earlier this might seem exciting, new and interesting in year one but we have to think beyond the year of change to the essence of good communication in years two and beyond. One investor group representative has mentioned that if audit reports become too long and cluttered with procedures that they will not be good communication and that, if they evolve in that manner, some signposting of "what's new" in year two might be something to consider.

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5. Finally, and perhaps the most important point is that in the UK, we are very fortunate to live in an environment of a corporate governance reporting framework which has also been actively developed, most recently by the FRC. In the UK the company has to explain its business model and principal risks and mitigation. Concurrently with the auditor reporting changes, the FRC has introduced reforms to require Audit Committees to look at the scope of the audit and consideration of key judgments formed by management and to report on these in their report to shareholders, describing how they were resolved. In my view the Auditors Report should not be used to fill the gaps left by company reporting and governance frameworks.

I hope this has been a useful commentary. Thank you for your attention and I will be very happy to answer any questions during the panel question and answer session.

Yours faithfully

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