

Sir Adrian  
CAD-01195

RECORD OF MEETING WITH MR DEREK FOSTER, RECENTLY RETIRED TECHNICAL PARTNER OF ARTHUR YOUNG, ON 26 SEPTEMBER 1991

Present:

Derek Foster

Sir Adrian Cadbury

Nigel Peace

Mr Foster said that he had been Technical Partner at Arthur Young for a number of years and had also been the partner whom members of the firm consulted if they were concerned about independence-related issues. Independence was a very difficult area. It was an attitude of mind, not something laid down in training.

2 Generally, the audit business had become very much less professional and more commercial. The publication of 'league tables' demonstrated the seriousness of losing clients. Matters had become significantly worse following the collapse of SSAP 16 on inflation accounting. Finance Directors had discovered then that they could get away with ignoring the profession. In the absence of a firm stand then, matters had grown steadily out of hand.

3 One problem was the 'creeping crumple'. An auditor would let a point through although he did not like it because the sum was immaterial. The precedent would be established however and next year the sum would be larger, or it would be accepted in another firm where it was not realised that it had originally been conceded only on grounds of immateriality. The treatment of the depreciation of freehold property was a classic example. Very many issues had at their root concern by the client about their effect on reported profit.

4 Overt pressure from clients resulting for example from 'opinion shopping' was not very common. Companies might occasionally claim that a particular treatment had been allowed in another company - in such cases it had been his practice to check the claim out with the Technical Partner of the other company's auditor. Usually the other company's circumstances were not quite the same. However often they were close, and certainly it was very difficult for the Technical Partner to make a stand after the Audit Partner had reached agreement with the client.

5 Underlying the problem was the very rapid growth of the accountancy profession. In the old days (before the removal of the Companies Act requirement limiting the number of partners to 20) every partner would have had a detailed knowledge of the financial affairs of all the firms' clients. This was no longer feasible and the focus of the top partners was on the commercial business of retaining their client base. Mr Foster agreed with Sir Adrian that no adequate new structure had been put in place to replace the old collapsed one. He commented specifically that there was huge pressure on younger partners to retain their major clients, who could account for much more than 15% of their personal workload.

6 Another fundamental problem was that the partner was instinctively drawn to the side of the client. This did not square easily with his formal responsibility to the shareholders. It was not apparent however what could be done to give the shareholders more influence.

7 Mr Foster did not think that pressure to retain non-audit business was of great significance to the independence question. He accepted that it had to have some impact but he did not feel that it was likely to weigh very heavily in the resolution of a particular audit problem. (Nor for that matter was quoting the relevant SSAP likely to have much impact. The main lever against the client was the prospect of unfavourable press comment.) Separating audit and non-audit work within firms would have the unfortunate effect of pushing firms' brighter staff away from audit work altogether.

8 Strong Audit Committees might help a little. However there were not many major breaches of the sort Audit Committees might be expected to stop. The problem was rather the host of small issues, perhaps immaterial in themselves, which Audit Committees would be just as likely to let through (quoting accounting standards and legal advice). Also Audit Committees were least likely to work in the companies that most needed them - especially those under the control of a powerful individual. One could not legislate for independence.

9 Mr Foster said that he believed that auditors would only really be strengthened if they felt they had the backing of the Institute. There had been clear breaches of standard over the years which the Institute had not been prepared to anything about in the absence of a formal complaint, on the grounds that it was a matter for the member. He believed that if for example there was critical press comment about a particular company's accounts, the

Institution should make it its business to look into it, and make known its concern. Sir Adrian noted that there was increasing monitoring of companies' accounting practices (eg the Phillips and Drew report, and monthly publication Company Reporting), although these did not themselves carry authority.

10 Mr Foster doubted that audit rotation would bring significant advantages, but said it would cause enormous disruption for the client.

11 Mr Foster similarly doubted that liability was a significant factor in the independence context. Auditors<sup>s</sup> were certainly concerned about their liability, and increased reporting would extend it, but the prospect of being sued was unlikely to weigh as a significant factor when a particular audit problem was under consideration.

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