

NOTE OF MEETING WITH MR JOHN STEVENSON ON 1 OCTOBER 1991

Present:

John Stevenson (recently retired technical partner of Touche Ross)
Sir Adrian Cadbury
Nigel Peace

The meeting was held to discuss the independence of auditors.

2 Mr Stevenson said that auditors typically preferred to agree with their clients rather than disagree. The question was whether at the borderline they agreed with their clients too much. He saw it as an issue not of independence, but of what the rules were. 'Materiality' allowed a lot through. So did the sorry state of accounting standards, the following of which - as for example in Polly Peck's case - did not necessarily lead to a 'true and fair view'.

3 As a young partner he had been shocked to be told by a senior partner that 'profit was negotiable', but the statement was correct. There were areas of judgement (for example, the value to be put on stocks and uncollected debt) where there were significant margins and it was hard for the auditor who was unhappy with what was proposed to disagree with directors who knew the business much better than he did and who had the primary responsibility for preparing the accounts.

4 It was impossible for auditors to be truly independent. No man was an island. Auditors had financial and personal relationships with their clients because the company paid the audit fee and they had regular working contact. Auditors would have greater independence if they were appointed and remunerated by an independent Audit Commission (as was the case for Local Authorities) but the separation of audit and accountancy would lead to a deterioration of the quality of audit staff because audit work was not exciting. The real problem was that audit partners did not have a sufficient foundation of faith in the standards. The work of the ASB was extremely important. When the rules were right auditors would believe in them and use them as a basis for exercising their professional objectivity.

5 One of the reasons why the financial statements were such a mess was the absence of a clear view on their purpose. Were they solely designed to report on the past, or were they intended as a guide to the future? This affected for example whether a historical or forward-looking basis should be adopted for valuations. Different users required different figures. He appreciated that the ASB were seeking a definition of purpose, but did not think that they yet had the right answer.

6 This said, the statements did generally contain all the relevant information. He did not have sympathy for those who complained that important facts were tucked away in notes to the accounts - accounts users had to be prepared to study the whole document.

7 Mr Stevenson doubted that matters could be completely resolved by tightening the rules because there was a level beyond which tightening would not be considered acceptable. He accepted that there was a problem of auditors not standing up to management at the end of the day, revealed by notes to the accounts that did not adequately clarify the point in question. The commercial pressures were there and a junior partner would have a hard job explaining to a senior partner why an audit had just been lost. Auditors were much more likely to be appointed partners for their salesmanship skills than their technical skills, although firms did have Technical Partners. When a problem had arisen in his own firm, the first question the Managing Partner had always asked him as Technical Partner was what were the risks. That did depart from being objective, in his view.

NDP

11.10.91

- 1) Agreement at borderline is a ? of the rules.
- 2) Alcy-stds vs. true fair view. Message from alcy stds may not be true/fair
- 3) Who is resp. for interpretation of facts? P.P. info. Was there.
- 4) In absence of clear rules & in absence of stated objective
Any fin. statement prepared for particular purpose.

Form opinion in accordance with law. At margin of valuation liabilities/stocks, opinions of mgt., dir's resp. to prepare auditor
Can only disagree
Draw the veil, understd. of opinion. What also mean?

- 5) Independence is a myth. Other rule is red herring vs. audit fee.
Objectivity is aim. Others must appoint/pay auditors.
Audit separate from alcy. Will not get good auditors.
Backbone, confidence in his post. Belief in what he is doing.
- 6) O/S. on Bd. majority, audit fees wd. follow, get direct to auditors.
- 7) Objectivity, disciplinary role of Institute.
- 8) Competitive pressure, fixed fees, quality of work...
- 9) Technical depts. ensure consistency.