

June 7, 2019

Sir Donald Brydon
Brydon Review
Orchard 1, 1st Floor
Department for Business, Energy & Industrial Strategy
1 Victoria St
London SW1H 0ET
UNITED KINGDOM

Via email: brydonreview@beis.gov.uk

INDEPENDENT REVIEW INTO THE QUALITY AND EFFECTIVENESS OF AUDIT

Dear Sir Donald,

IFAC (International Federation of Accountants) welcomes the opportunity to comment on the *Independent Review into the Quality and Effectiveness of Audit* (Review). IFAC provides an international perspective, drawing on input from across our global network of member organizations in 130+ countries, representing over 3 million professional accountants.

We support your constructive, forward-looking efforts to address challenging questions about the scope and purpose of audit. The *Call for Views* raises questions central to many issues facing the audit profession and its continued future relevance to both developed and emerging economies.

We note that FRC audit standards are adapted from International Standards on Auditing (ISA). ISA are set by the International Auditing and Assurance Standards Board (IAASB), an independent body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services. Supporting the IAASB's work, and global adoption and implementation of its standards, is part of IFAC's core mission.

While the *Call for Views* does not attempt to reconcile UK and global practice, we appreciate the UK's position of regulatory leadership in the global financial reporting infrastructure. With this in mind, and as you consider UK appropriate reforms, we urge you to consider the fundamental importance of harmonized international audit standards which are an essential underpinning of today's globalized business environment.

Another area in which we urge vigilance is with respect to the impact of proposed reforms on small and medium enterprises. Solutions that are intended to further mitigate the failure of a large, high-profile entity may also create unintended implementation burdens for this important sector of the economy.



In addition to supporting the development, adoption and implementation of high-quality international standards, IFAC further serves the public interest through professional accountancy organization capacity building and speaking out on public interest issues. A holistic view derived from these activities informs our responses to specific questions contained in the *Call for Views* (see Appendix).

IFAC stands ready to assist you as you undertake this important work.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Kevin Dancey', written in a cursive style.

Kevin Dancey
Chief Executive Officer, IFAC



INTRODUCTION

The audit of an entities financial statements enhances confidence of investors, analysts, regulators, rating agencies, and others about the entity's financial position, financial performance and cashflows, all of which are reported in accordance with financial reporting standards. The auditor's objective, in accordance with auditing standards, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. The audit helps directors and management assess the robustness of the financial information upon which they rely. It also provides insights into the company's financial controls and associated risks.

However, recent corporate failures, typically resulting in job losses and destruction of shareholder value, have raised questions about audit quality. In addition, they have likely exacerbated a gap in understanding that exists between the public's presumption that audits attest an organization's viability versus the definition and practice of audits in legislation and standards (as articulated in paragraph 22 of the *Calls for Views*). Audited financial statements of an entity's financial position, performance and, where relevant, cash flows, represent a moment in time. They do not provide a forecast. They are, however, frequently seen by the public to represent an assertion about future performance and are based on a presumption that the entity is a going concern for the foreseeable future (i.e. at least 12 months from the date of the audit opinion).

Further complicating the picture, much of the value of contemporary corporate entities may not be adequately reflected in the financial reports to shareholders – either because much value is represented by assets that may not be recorded on the balance sheet (e.g., brand, intellectual property, goodwill) or, conversely, because recorded intangibles are mis-valued considering the underlying trading weakness of the business. Therefore, any changes to audit cannot be discussed in isolation from the information reported by the entity, upon which auditors may be called to express an opinion.

The Case for Change

The standards and processes underlying financial reporting have been developed over many years. Overall, they function well to provide the company and its board with a pathway to preparing a comprehensive, balanced and transparent financial report. However, the emergence of Integrated Reports, Strategic Reports, Corporate Sustainability Reports, and other equivalents reflects shareholder and broader societal interest in expanded corporate reporting that examines current and prospective business environmental factors as well as an organization's accountability for all the resources (capitals) it utilizes. For example, Integrated Reporting helps stakeholders better understand how business models seek to create value, and the associated risks. Over time, expanded reporting may help avoid large, high-profile, unexpected corporate failures. The nature and extent of corporate disclosure content assured by the audit profession must, therefore, be re-assessed by the accounting profession, regulators, auditors, and other impacted stakeholders.

Our view is that a more holistic approach to audits will yield useful information. Confidence in a corporate entity and in its financial statements and other forms of external reporting are interdependent because all the activities of the entity ultimately impact its cash flows. However, the benefits of expanding the audit's scope should support, or even enhance, consistency and comparability between organizations and jurisdictions, rather than increase fragmentation risk.



We strongly support the development of international assurance practice and standards related to different types of “extended external reporting” and we note the IAASB’s recently issued and highly relevant Consultation Paper, [Extended External Reporting Assurance](#).

Effectively addressing the expectation gap requires an evolution to the overall corporate reporting ecosystem that encompasses all stakeholders contributing to corporate disclosure and the audit, including preparers of reports, audit committees, directors and management. Corporate reporting incorporates several parallel reporting systems:

- Management information
- Regulated financial reporting
- Investor relations reporting
- Sustainability reporting (ESG) – regulated and voluntary
- External organizational information – social media, etc.

Sometimes this information is aligned; frequently it is not.

Comprehensive assurance engagements can only be undertaken by auditors with a thorough knowledge of the entity’s business and value creation model and its external environment. Consideration could be given to enhancing the audit process with a formal review of the external environment (e.g., the shorting of shares in public markets, commentary on social media, etc.) and consideration by senior partners of the appropriateness of signing an unqualified opinion. Any evolution in this system has implications for all stakeholders, including investors, regulators, management, directors, auditors, and standard setters.

We also believe it could be beneficial to consider that some of the legitimate needs of regulators and other stakeholders may be better served outside the scope of the financial statement audit. This could assist in reducing the expectation gap that the audit can satisfy all stakeholder needs.

Finally, we specifically note two stakeholder issues identified in your Review.

Role of the directors and going concern: We strongly believe those charged with governance are best placed to oversee the audit on behalf of shareholders. It is therefore critical to strengthen this role and to address perceptions that audit committees are not sufficiently independent of management, or that there is an insufficient link to shareholders. It is incumbent on companies (audit committee members, directors, management) to ensure transparency and effective communication with stakeholders about the audit, including scope, quality of audit firm, important audit findings, matters of going concern, capital maintenance, etc.

In an interconnected, globalized marketplace, any form of modification to the auditor’s opinion regarding an entity’s viability can serve to hasten corporate failure. The auditors should have sufficient knowledge of the business and external environment factors to be able to evaluate management’s assessment, or where appropriate the assessment of those charged with governance, of the entity’s ability to continue as a going concern. But the directors bear the ultimate responsibility for recognizing material issues (whether identified during the audit or otherwise), notifying stakeholders, and taking appropriate mitigating action. The IAASB’s new and revised auditor reporting standards include revisions to International Standard on Auditing



(ISA) 570, *Going Concern*, in terms of drawing attention to material uncertainties related to going concern. Furthermore, ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, introduces the communication of Key Audit Matters that facilitate better communication and transparency with shareholders and other external stakeholders.¹ But the auditor is a supplemental source of information; responsibility for honestly and transparently conveying material issues related to the going concern of the entity resides with company management and directors.

Fraud detection and use of technology: Advances in technology and artificial intelligence are expected to enhance the auditor's access to more and different types of information, as well as to enable more comprehensive analysis of information in ways that enhance both the auditor's capacity to opine on fair presentation of the financial statements as well as the auditor's capacity to identify and respond to fraud risk factors. We support the Review's intention to gather stakeholder input on the extent to which this transformation is taking place in practice, as there is often a significant expectations gap in relation to the auditor's role in regard to fraud. We encourage the Review to explore whether auditors should engage more technology, and whether doing so compliments or stifles the auditor's professional judgement, such that detection of material fraud takes on more prominence in the audit. However, unless an engagement is fraud-specific, the annual audit engagement is unlikely to ever be the appropriate vehicle for detecting fraud.

¹ ISA 701. 15 states that going concern issues - although by nature are Key Audit Matters - shall not be reported in Key Audit Matters. ISA 570. 21-24 requires that there could be e.g., a modified opinion or separate section headed "Material uncertainty related to going concern", depending on how management has addressed the matter in the financial statements.



APPENDIX

Q1 - For whose benefit should audit be conducted? How is it of value to users?

Consistent with the purpose of the standards governing financial reporting (e.g., IFRS Standards, US GAAP, etc.), the primary beneficiary of audits of financial reports should be shareholders or investors, in addition to other stakeholders including regulators, creditors, rating agencies, employees, etc. It should be noted that each user group may have different expectations from the audit.

The audit of a company's financial statements enhances confidence of investors, analysts, regulators, rating agencies, and others about the entity's financial position, financial performance and cashflows, all reported in accordance with financial reporting standards. The auditor's objective, in accordance with auditing standards, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. The audit helps directors and management assess the robustness of the financial information on which they rely and provides insights into the company's financial controls and associated risks.

Q2: Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?

Currently, audits focus on the financial statements and related disclosures, with some additional information contained in the annual report being read for consistency. However, confidence in the corporate entity and in its financial statements are interdependent because all the activities of any entity will ultimately impact its cash flows. For this reason, we support a more holistic approach to audits that will yield useful information. For example, Integrated Reporting aids shareholders and other stakeholders in better understanding business models, how those business models seek to create value, the viability of the business model and the associated risks. However, the benefits of expanding audit scope must not negatively impact consistency and comparability between organizations and jurisdictions. We strongly support the development of international assurance practice and standards related to these types of "extended external reporting." Such advances in corporate reporting must clearly indicate to investors and other stakeholders what information is subject to audit versus some other level of assurance or review.

Q3: Should UK law be amended to provide greater clarity regarding the purpose of an audit, and for whom it is conducted? If so, in what way?

While UK law (or changes to it) are beyond the scope of IFAC's focus, we urge you to include cross border impacts as an integral part of your considerations in taking the Review forward, balancing needed reforms deemed appropriate for the UK with avoiding fragmentation of global harmonization achieved with respect to international standards for audits. Thus, differentiation is necessary between changing the scope of the audit and having an auditor perform supplementary assurance services in certain circumstances. The former potentially has global impacts, whereas the latter could be jurisdiction specific.

Caution should also be noted in designing solutions that address large, high-profile audit failures, which could create unintentional implementation burdens on small and medium sized enterprises.



Q4: Do respondents consider there is an expectation gap?

Yes.

Q5: If so, how would respondents characterise that gap?

We agree with the characterisation in paragraph 22 of the Call for Views, that the expectation gap is “a perceived difference between what users of financial statements and the public expect from an audit, and what an audit is required to deliver under existing UK law and auditing standards.” The audited financial report is a statement at a point in time, it does not contain a forecast, but often is taken to represent a projected assertion about future performance or a presumption about the future viability of a company.

While we consider the “delivery gap” important, as detailed in our response to Q6 below, we believe that the crux of public concern about audit stems from a failure to understand the difficulty auditors face in reporting on matters such as “going concern” in the absence of adequate reporting to investors and employees by directors first. In the absence of the directors conveying an entity’s going concern difficulties, a qualification in an audit report is likely to cause a significant loss of value to investors for which the auditor could well be liable.

While we recognize the Review is focused on auditors, addressing the expectation gap effectively calls for looking across the participants in the corporate reporting ecosystem, including preparers of reports, audit committees, directors and management. It is important to consider where addressing gaps in the expectations placed on audit might require broader changes, including a more rigorous approach to the accountability of company management for high quality financial reporting processes and controls.

Q6. Is there also a significant ‘delivery’ or ‘quality’ gap between auditors’ existing responsibilities in law and auditing standards, and how those responsibilities are currently met?

The “delivery” or “quality” gap, and “quality” more generally, have been an important focus of the profession, regulators, and standard setters for many years. This includes the development of extensive quality management requirements in standards, regulatory oversight programs, and substantial investment by audit firms themselves. The significance of the gap is likely to be variable internationally, and measuring its extent objectively is inherently challenging. Notwithstanding these challenges:

1. The quality of audited financial reporting has reached a level which clearly underpins confidence and decision making and allows effective capital markets to exist in all major economies. Focus on nominal progression and continuous improvement is appropriate and warranted, rather than deducing major shortcomings.
2. We believe it is time to turn to broader questions concerning how the scope and purpose of audit could evolve to address expectations that would not be served even by a perfect audit as defined by existing laws and standards.



Q7: What should be the role of audit within wider assurance?

The financial statement audit remains central to trust in capital markets and beyond. We agree with the Call for Views that it exists within a wider, expanding set of needs for assurance across organizations. We believe clarity as to the nature of different assurance components and how they fit together is essential so that stakeholders can understand what comfort they can and can't legitimately take. We would recommend a deliberate approach to the overall design of wider assurance from the outset as the Review considers scope and purpose. IFAC notes the recently published (February 2019) Consultation Paper, *Extended External Reporting (EER) Assurance*, by the IAASB in terms of addressing the need for assurance engagements beyond the audit of financial statements.

Q8: Can the level of assurance that an audit provides legitimately vary in different circumstances, for example depending on the business sector in question, and the nature of the entity's business risks?

Yes, notionally the level of assurance could vary depending on a range of circumstances. However, we believe it is important to define a clear target level of assurance for audits in order to provide a product that is as consistent and comparable as possible between organizations and jurisdictions. The International Standards on Auditing (ISAs) currently determines that the auditor should obtain *reasonable assurance* about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. In saying that, we do believe there is potential value in exploring additional communication factors to clarify the context in which the auditor opinion is expressed. The introduction of Key Audit Matters in the auditor's report is a significant recent initiative toward this direction, and we would support efforts to explore the call for more comprehensive auditor reporting (and company reporting) made by the House of Commons Business, Energy and Industrial Strategies Committee ("The Future of Audit," Nineteenth Report of Session 2017-2019).

Q9. Are the existing boundaries between internal and external audit clear?

Better disclosures, explaining the reliance of the audit committee and the external auditors on the work product of internal auditors, would improve audit report quality. However, the audit committee and external auditor must have the ultimate responsibility for an external audit report. It is important that the audit work undertaken by external and internal auditors is undertaken as effectively and efficiently as possible.

Q10. To what extent should external auditors be able to use evidence obtained from work performed by internal auditors in drawing conclusions?

See Q9. Evidence can be used to the extent that the external auditor can be confident in the work of the internal auditor and to the extent that it covers areas of relevance to the external auditor. We believe ISA 610 adequately addresses the existing boundaries between internal and external audit and that the use of internal audit as contemplated in that standard is appropriate.



Q11. Do current eligibility requirements for external auditors focus too much on independence at the potential expense of market innovation and the quality of the audit product?

Audit committees should consider all these issues in their auditor selection, but independence is critical, including the perception of independence. This requires careful consideration of the nature and extent of other services provided by the auditor to the entity. We note there are many internal controls and processes in place that allow auditors to maintain independence while innovating and providing other assurance services. However, regulatory influence increasingly means that in some jurisdictions, regulatory provisions can limit those charged with governance's ability to use supplementary support services from the auditor. Entities, and ultimately financial statement users, should not suffer from lack of access to services by the auditor in terms of synergies and access to depth of knowledge others do not have.

Q12: Should directors make a more explicit statement in respect of risk management and internal controls? If so, should such a statement be subject to audit?

Opportunities to strengthen the responsibilities of directors and auditors relating to internal controls over financial reporting (ICFR), including risk management, should be explored.

Q13: Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified?

Within the context of the IAASB's current standards, auditors' responsibilities for understanding and evaluating an entity's system of internal control are indeed being enhanced and clarified through the revision to ISA 315 (Revised). In June 2018, the IAASB approved an [exposure draft](#) (ED) of ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, that proposes essential enhancements to the auditor's risk assessment process, with the objective of establishing more robust requirements and appropriately detailed guidance to drive auditors to perform consistent and effective identification and assessment of the risks of material misstatement. ED-315 separately highlights the importance of, and provides enhanced requirements for, the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, taking cognizance of changes in, and the evolution and increasingly complex nature of the business environment, including recent developments relating to internal control.

Q14: Auditors are currently required to report to audit committees their views on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?

We believe that calls for auditors to report publicly on ICFR, and on other controls where relevant, are worthy of consideration.

Q15: Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?

See response to Q16 below.



Q16: Should there be greater transparency regarding identified “events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern”?

In an interconnected, globalized marketplace, any form of modification to the auditor’s opinion regarding an entity’s viability can serve to hasten corporate failure. The auditors should have sufficient knowledge of the business and external environment factors to be able to evaluate management’s assessment, or where appropriate the assessment of those charged with governance, of the entity’s ability to continue as a going concern. But the directors bear the ultimate responsibility for recognizing material issues (whether identified during the audit or otherwise), notifying stakeholders, and taking appropriate mitigating action. The IAASB’s new and revised auditor reporting standards include revisions to International Standard on Auditing (ISA) 570, *Going Concern*, in terms of drawing attention to material uncertainties related to going concern. Furthermore, ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, introduces the communication of Key Audit Matters that facilitate better communication and transparency with shareholders and other external stakeholders.² But the auditor is a supplemental source of information; responsibility for honestly and transparently conveying material issues related to the going concern of the entity resides with company management and directors.

Q17: Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?

No, the Viability Statement should be prepared professionally, prudently, and comprehensively.

Q18: Should such a statement be subject to assurance?

The statement is the responsibility of the directors. Assurance should be limited to the process, with a focus on the assumptions made by the directors – the reasonableness of the assumptions in the circumstances, whether the information presented has been prepared based on those assumptions and whether material assumptions have been adequately disclosed.

Q19: Who might be capable of giving such assurance?

Audit professionals have the skills to undertake assurance processes effectively. This should include, where needed, using the work of appropriately skilled professionals from other disciplines who can contribute to the assurance process.

Q20. Is there a case for a more forward-looking audit? What would be the main benefits and risks?

Audits already cover a large amount of forward-looking information, including the assumptions in valuation of many items on balance sheets. To some extent, every asset and liability reflects events expected to take place at some time in the future – the inflow or outflow of economic benefits. Notwithstanding, there are major challenges in going beyond the context of financial

² ISA 701. 15 states that going concern issues - although by nature are Key Audit Matters - shall not be reported in Key Audit Matters. ISA 570. 21-24 requires that there could be e.g., a modified opinion or separate section headed “Material uncertainty related to going concern”, depending on how management has addressed the matter in the financial statements.



reporting and seeking to audit other forward-looking statements such as a business viability statement. As recognized in the Call for Views, there is a risk of boiler plating and not providing valuable information arising from the substantial risks involved in attesting to such a statement without adequate context.

As stated in Q2, we support a more holistic, extended corporate reporting framework that yields more useful information, including forward-looking information, and would require new assurance policies and standards. However, even taking a more holistic view will not always make it easier to detect mistakes in valuation judgements and decisions that directors, managers, and auditors can make.

Q21: Would audit or assurance over financial and non-financial information outside the annual financial statements (for example KPIs or non-financial metrics, payment practices or half-yearly reports) enhance its reliability and therefore be of benefit to users?

As stated in 2 above, confidence in the entity and the financial statements are interdependent. Wider assurance would increase the robustness of the audit of the entity but must be provided in the context of appropriate standards and definitions.

Q22. If so, what information might usefully be subject to audit or another form of assurance and why?

The outcome KPIs that link to the cash flows of the entity over time.

Q23: Do respondents agree that the value and quality of the audit product should be considered separately from the effectiveness of the audit process?

Yes, we believe the value and quality of the audit product in terms of output (quality and value of audited financial reports) and the perspective of end users (investor confidence in audited financial reports and their value to investors) should have primacy – the audit process is one of multiple factors involved in achieving these outcomes. As recognized in the Call for Views, an over emphasis on process can result in unintended consequences such as i) encouraging a compliance rather than outcome and judgement-based approach to auditing, ii) taking focus away from the end-product, thereby stymieing efforts to improve the value of auditing, or iii) lessening the necessary reliance on sound audit judgement and conviction in dealing with audit committees and management (refer also to Q24 below).

Q24. Do respondents consider that emphasis placed by auditors on ‘completing the audit file’ for subsequent FRC inspection can eclipse the desired focus on matters requiring the exercise of considered judgment?

Yes, this is an important risk. We believe reliable audited financial reporting is achieved primarily through the exercise of professional judgment by the auditor. While they are an important part of the regulatory toolkit, process-based audit inspection programs do not represent or measure in full the professional judgment involved in providing a high-quality audit.



International best practices for regulatory inspection programs³ outline negative impacts that can arise from solely focusing on “volume of activities (inspections) or violations detected (and sanctions) as indicators,” rather than “the achievement of social well-being (safety, health, environmental protection etc.)” – in the case of financial statement audits, social well-being includes in particular the quality and value of audited financial reports and the confidence of investors. Such negative impacts can include “perverse incentives to inspecting agencies, since they then have an incentive to achieve low compliance levels, which will give them more volume,” in addition to incentivising a compliance-based rather than outcomes and judgement-based approach by auditors.

Q25. What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?

Greater disclosure would be valuable. However, a graduated approach must be approached with caution so as not to introduce subjective opinions that have the effect of increasing complexity.

We believe that current requirements to disclose key audit matters strike an appropriate balance between an audit opinion on the financial statements as a whole (which some may refer to as a binary conclusion) and the provision of more nuanced information on the auditors’ considerations with respect to those matters that, in the auditor’s professional judgment, were of most significance in the audit. The binary conclusion is clearly valuable to users of financial reports and drives auditor practices toward a clear and consistent outcome, while key audit matters have been demonstrated to be providing valuable additional information.

Going beyond the scope of the current requirements for key audit matters is challenging and calls for concurrent developments in financial reporting that would allow for more graduated disclosure and measurement around estimates, valuations, and impairment of assets in financial reports. For example, many assets and liabilities notionally involve a range of possible values with a range of probabilities surrounding their realization. In the absence of a more graduated approach in financial reporting, the auditor would potentially be in the impracticable position of disclosing their own views on such matters rather than testing and opining on disclosures made by companies. This has ramifications for independence and auditor liability.

Q26. Could further narrative be disclosed alongside the opinion to provide more informative insights?

Yes, it could further describe the risks addressed and the discussion with the audit committee. It is important that these discussions are reported by the entity and confirmed by the auditor. (See response to Q25 above.)

Q27. What would prevent such disclosures becoming boiler plated?

A focus on the specific risks of the entity.

³ OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections



Q28: To what extent, if any, has producer-led audit (including standards-setting) inhibited innovation and development for the benefit of users?

Effective standard-setting requires an appropriate mix of input from users, regulators, academics, auditors, and other stakeholders. The IAASB's draft strategies and work plans are exposed for public comment, and the development process of its International Standards, formalized in the IAASB's [Due Process and Working Procedures](#), requires that public comments from all stakeholders are taken into account. Furthermore, public interest issues are closely examined and the IAASB publicly explains the Board's rationales for its decisions via Explanatory Memoranda and Bases for Conclusions. The Public Interest Oversight Board (PIOB) has oversight of critical elements of the IAASB's processes, including the nomination of the members of the IAASB, the terms of reference of the IAASB, the IAASB's strategy and work plan, and due process of the IAASB.

We agree that innovations in audit processes that benefit users should not be inhibited by standard-setting. This said, there are benefits of consistency and comparability from harmonization (not fragmentation) around high quality standards for the preparation and audit of financial statements.

Q29. What role should auditors play in determining whether the directors are complying with relevant laws and regulations, including with respect to matters of capital maintenance? Is it appropriate to distinguish between matters which may materially affect the financial statements and other matters?

No response given the UK specificity of the question.

Q30. Does a perceived inconsistency between company law and accounting standards as regards distributable reserves inhibit auditors from meeting public expectations? How might greater clarity be achieved?

No response given the UK specificity of the question.

Q31. Should distributable and non-distributable reserves be required to be disclosed in the audited financial statements?

No response given the UK specificity of the question.

Q32. How do auditors discharge their obligations relating to whether the entity has kept adequate accounting records? Are the existing statutory requirements effective in setting the bar for auditors at a high enough level?

No response given the UK specificity of the question.

Q33. Should there be more open dialogue between the auditor and the users of their reports? For example, might an annual assurance meeting open to all stakeholders prove valuable?

We support opening dialogue between auditors and users, including investors, and consider that this may help address the expectation gap. However, we stress the need for any new



requirements to be proportionate, with a consideration of their application to and the needs of different audited entities.

Q34. Should more of the communication and resulting judgments that occur between the auditor and the audit committee be made transparent to users of the financial statements?

We note support from some investors for increased transparency around the communications and resulting judgements that occur between the auditors, management and the audit committee. Indeed, most audited financial statements would reflect adjustments to the numbers and/or the disclosures, which arise throughout the audit process, with the audit process relying on ongoing communication between these three key groups. There are practical challenges of making such communication between auditors, management and audit committees transparent to users, including the risk of inhibiting it.

Q35. Should there be enhancements to the extended audit report, such as an obligation to update on key audit matters featured in the previous audit report?

Communicating the reasons for no longer considering an issue a key audit matter (KAM) is worthy of consideration because the absence of an issue previously reported always gives rise to questions about what has changed. To explain what has changed helps tell a better story over time. Having said that, it is important to be cognizant of the purpose, in accordance with ISA 701, of communicating KAMs in the auditor's report, namely to communicate matters that, in the auditor's professional judgement, were of most significance in the audit of the current period's financial statements. KAMs are determined from those matters that required significant auditor attention in performing the current period's audit in the context of the risks, circumstances and conditions prevailing in the current period. Therefore, proposals for change should carefully consider the bases for conclusions in arriving at the position presented in the current standard and the possible effects of any revisions.

Q36. Do you believe that users' expectations of auditors' role in fraud detection are consistent with the requirements in UK law and auditing standards? If not, should auditors be given greater responsibility to detect material fraud?

Advances in technology and artificial intelligence are expected enhance the auditor's access to more and different types of information, as well as more comprehensive analysis of information in ways that enhance both the auditor's capacity to opine on fair presentation of the financial statements as well as the auditor's capacity identify and respond to fraud risk factors. We support the Review's intention to gather stakeholder input on the extent to which this transformation is taking place in practice, as there is often a significant expectations gap in relation to the auditor's role in regard to fraud. We encourage the Review to explore whether auditors should engage more technology, and whether doing so compliments or stifles auditor's professional judgement, such that detection of material fraud takes on more prominence in the audit. However, unless an engagement is fraud-specific, the annual audit engagement is unlikely to ever be the appropriate vehicle for detecting fraud.



Q37. Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?

We believe ISA 240 is currently a sound basis for appropriate fraud detection but recognize that continuous improvements can always be considered.

Q38. Would it be possible to devise a ‘reasonable person’ test in assessing the auditor’s work in relation to fraud detection?

Our consultations have not been conclusive on this point.

Q39. Should auditors be required to evaluate and report on an audited entity’s systems to prevent and detect fraud?

As explained in our answer to Q12, above, the responsibilities of directors and auditors relating to internal controls over financial reporting (ICFR), including risk management and fraud detection, can and should be strengthened.

Q40. Is the audit profession’s willingness to embrace change constrained by their exposure to litigation?

We believe auditors strive for audit quality regardless of the liability regime. However, some jurisdictions have recently enacted increased penalties for auditors which could deter entry of small practitioners in the audit market.

Q41. If there were a quantifiable limit on auditor liability, how might this lead to improvements in audit quality and/or effectiveness?

The response is subjective, but auditors should be willing to consider wider forms of assurance in a different liability regime.

Q42. Should company law make auditors potentially liable, or otherwise accountable, to all stakeholders who reasonably rely on their audit work and their published auditor’s report?

No, liability should relate only to those to whom the auditor’s report is addressed. While it could be envisioned to expand the addressees of the audit report to other stakeholders (e.g. employees, business partners, etc.), any proposal for change of this nature would necessitate careful consideration of the potential consequences. If the nature of audit changes, it would be necessary to consider what assurance is being given, to whom and why and whether or not limitations of liability might apply.

Q43. How might quality of the audit product be improved if the approach to liability was altered, and what reform might enable the most favourable quality improvements?

See Q41 above.



Q44. To what extent (if any) are firms unable to obtain the desired level of professional indemnity insurance to minimise the risk of being unable to meet a significant claim relating to their statutory audit work? How significant is this risk for both the largest firms and other firms undertaking audits of Public Interest Entities?

No response given the UK specificity of the question.

Q45. How far is new technology actually used in audits today? Does the use of technology enable a higher level of assurance to be given?

Technology-driven tools and applications that facilitate a transition from transaction sampling to examining virtually all transactions are not in common use today – limited to large firms who have invested in the development or acquisition of these tools. This disparity in access to technology is relevant to the UK where there are a significant number of smaller sized audit and assurance practices who will not have such access in the short to medium term. It is difficult to assess when the majority of the audit practitioners will be in a position to adopt advanced data analytics applications.

Further, many UK companies have overseas operations. Given that not all jurisdictions are adopting technology at the same pace, we believe care must be taken with respect to expectations placed on multinational public interest entities and the extent to which they will use advanced technology tools.

Finally, technology will enable more effective and efficient evidence gathering, and analysis tools will allow for better corroboration of evidence. Greater reliance on evidence gathering using advanced technologies does not, however, *necessarily* lead to “more assurance” (reference Q36 above).

Q46. In what way does new technology enable assurance to be given on a broader range of issues than is covered by the traditional audit?

The emergence of certain business risks (e.g., cybercrime) and new business models (i.e., technology or digital-driven business) may require the auditor to adapt by focussing on new risks, as well as the broader consideration of possible sources of risks beyond (or outside of) the traditional general and subsidiary ledgers. For example, a company’s dependency on algorithmic based processes, including robotics, may give rise to the audit process considering the risks to and controls over key algorithms. As cybersecurity risks are becoming more complex, challenging business and government efforts to mitigate such risks, care must be taken with respect to expectations for the mitigation of fraud and risks to audit client controls.

Q47. Are there aspects of current audit procedures or output that are no longer necessary or desirable?

Not in our opinion. Notwithstanding the importance of recent corporate failures, overall, the standards and processes underlying financial reporting (both the preparation and audit of financial statements) have functioned well in providing balanced and transparent financial reports. However, we are supportive of targeted improvements that benefit investors and other stakeholders.



Q48. Given that a zero failure regime is not attainable (and arguably not desirable) how should the Review calibrate the value of audit in relation to the limitation of potential failure?

We suggest that potential conclusions and recommendations from the Review be considered subject to a reasonable cost-benefit analysis.

Q49. Does today's audit provide value for money?

Yes, in that it still provides confidence to the capital markets and the numerous stakeholders and participants that comprise market systems. However, given increasing investor demands for reliable, comparable information addressing sustainability and other topics outside the scope of traditional financial statements, as well as efficiencies gained from the increased use of technology, the value proposition to companies and broad-based users of audit reports may be in flux for the foreseeable future.

Q50. How should the cumulative costs of any extension of audit (whether stemming from this Review or other drivers of change) be balanced against the likely benefits to users?

Evidence-based cost-benefit analysis should apply, noting that increased costs of an extended audit can be offset by benefits realized by the audited entity or external stakeholders. Ultimately, shareholders bear the net cost of audits, so their input is central to the cost/benefit of any extension of audits.

Q51. What use do shareholders currently make of audit reports? Are they read by shareholders generally? What role does AI play in reading and analysing such reports?

We believe shareholders still primarily use audit reports in forming their views on the credibility of financial reports, and while they may not read the reports in totality, the existence of an unqualified audit report is fundamental to trust in financial reporting. Modifications to the audit report and the inclusion of Key Audit Matters could provide additional value in terms of shareholders' assessment of risk and management performance. While AI is increasingly being utilized in company analysis and ranking, we are not aware of the use of AI in analysing audit reports specifically.

Q52. Would interaction between shareholders and auditors outside the AGM be practical and/or desirable?

There may be some value in such interactions, however we believe this is highly dependent on the nature of AGM rules and broader governance framework in each jurisdiction.

Q53. How could shareholders express to auditors their ex ante anxieties to help shape the audit plan? Should shareholders approve planning matters for each audit, including scope and materiality?

We believe the audit committee, where it exists and functions effectively, is the appropriate governance body to represent shareholders in this capacity given their nexus between shareholders and the audited company. Seeking to involve the wider shareholder body in shaping and approving the audit plan could be highly problematic and lead to an inappropriate or diluted focus.



As audit committees do currently undertake this role, we disagree with the assertion made in the Call for Views that “there is no clear analysis of the wishes of shareholders in relation to audit scope, even though currently the law makes clear the audit is carried out for their benefit. By definition, the wishes of others are not taken into account either, other than as expressed in law.”

Q54. What assurance do shareholders currently obtain other than from audit reports?

We believe the assertions of company boards and management represent the main source of information shareholders obtain other than from audit reports in respect to the financial statements. As indicated above, to the extent that companies provide extended external reporting, this information (in the Annual Report, Corporate Sustainability Report, Strategic Report, etc.) could also be subject to assurance.

Q55. In what way would it be possible for auditors to report on the culture of the entity whose financial statements are being audited?

Audit firms involved in multi-year engagements develop a unique insight into an entity’s culture, risk appetite, control mindedness, and management style. This information could be an important, independent source of information to the Audit Committee and Directors more broadly. Therefore, we believe it is possible for auditors to report on organizational culture and such an engagement could be framed in multiple ways – an assurance engagement around a report on culture from the company, reported findings from a predetermined set of procedures, or important audit matters discussed with directors/management.

Q56. How can auditors demonstrate that appropriate scepticism has been exercised in reaching the judgements underlying the audit report?

The Audit Committee bears responsibility for evaluating the qualifications of the firm it contracts to perform the annual audit. In discussing qualifications, industry or other specific areas of expertise, audit scope, etc., and in exercising oversight over the effectiveness of the external audit, the Committee should develop an assessment of whether an appropriate level of scepticism will be (and has been) exercised.

The IAASB has always recognized that professional scepticism is pervasive to the work of the auditor and, therefore, it is encapsulated as a fundamental concept throughout the ISAs. The need for, and the auditor’s ability to exercise professional scepticism throughout the audit engagement lies at the heart of a quality audit. The IAASB’s Professional Scepticism Working Group is focused on continuing the IAASB’s work related to enhancing professional scepticism in its auditing and assurance standards in the public interest. This includes providing input into the IAASB’s other projects on how to more effectively respond to issues related to professional scepticism in those projects, collaborating with IESBA regarding touchpoints or cross-over topics between the work of the two Boards, and issuing periodic communiques to provide updates on the IAASB’s efforts to appropriately reflect professional scepticism in its standards.



Q57. Should the basis of individual auditors' remuneration be made available to shareholders?

No, information about individual compensation would only be useful if provided relative to other comparable level auditor employees at the firm engaged by the company, as well as across competitor audit firms.

Q58. Do respondents view audit costs as generally too high, about right or insufficient?

Various stakeholders will inevitably have differing views about the level of audit costs. We think the focus should be on audit quality in the first instance.

Q59. Would users of financial statements wish more detail on the make-up of audit fees?

This could be explored with users of financial statements.

Q60. Is the profitability of the audit function sufficient to sustain a high-quality audit industry?

Given the diversity of large and small audit firms globally, the profitability of individual firms is difficult to assess. Maintaining a high-quality audit function should consider the increased risk that auditors are taking, need for increased investment in innovation and technology, recruitment and retention of high-quality talent, etc. All of these factors impact the profitability and future attractiveness of the profession.