

# Independent review into the quality and effectiveness of audit

## **A. Purpose**

The Secretary of State for Business, Energy and Industrial Strategy (BEIS) invites Sir Donald Brydon to conduct a review into the quality and effectiveness of audit.

The review process needs to be a thorough examination of the issues and allow for gathering evidence and consulting with stakeholders and experts. Sir Donald is expected to submit a report to the Secretary of State for Business, Energy and Industrial Strategy by the end of 2019. The final report will be published and the Government will consult on its response to the review's recommendations.

## **B. Review Objectives**

The review is commissioned in response to the perceived widening of the "audit expectations gap" - the difference between what users expect from an audit and the reality of what an audit is and what auditors' responsibilities entail. Recent company failures have brought this gap into greater focus. There may be an additional gap between the information users of audited accounts believe is needed and what is available to them through audited financial statements or other publicly available information.

In general the audit opinion relates to past performance and the position of an entity at its balance sheet date. Expectations of audit and, more widely, assurance are growing and it is important that the audit responds effectively to those expectations.

The review is intended to take a fresh look at the scope of the audit, how far it can and should evolve to meet the needs of users of accounts, what other forms of assurance might need to be developed, and to define and manage any residual expectations gap. It will test the current statutory audit model and ask whether it can be made more effective as currently established or whether it requires amendment. It will consider how the audit product should be developed to serve the public interest in future, taking account of changing business models, new technology and stronger public expectations.

It is intended that as a result of the review's recommendations any expectations gap will be better understood and users of accounts will have greater assurance about the future of the entity concerned.

## **C. Scope**

The review's scope is taken to include the objectives and context included in these terms of reference.

The objectives of the review are ambitious and will result in the need to consider, amongst other things, the following:

1. Understanding the needs and expectations of stakeholders who make use of company audits:
  - a. The origins and perceptions of the expectations gap;
  - b. What can be done to ensure that investors and other stakeholders fully engage with audit and understand its scope and limitations.
2. The scope of audit:
  - a. What information future investors and the users of corporate information are likely to require a company to produce (drawing on the work of the FRC in this regard) and, in that context;
  - b. what assurance investors and other users of corporate information will need; and
  - c. how any extension of that assurance can be achieved at a proportionate cost to corporates.
3. How assurance is provided and how that assurance can be made more effective for investors:
  - a. From whom and how the assurance should be provided;
  - b. The extent to which auditors can and should assess whether underlying information is reliable;
  - c. The extent to which auditors can and should assess the impact of uncertain future events; and
  - d. How audit can respond to the opportunities and challenges of new technology and other forms of innovation to increase the assurance and effectiveness of audit.
4. How any change to the current statutory audit model will impact on potential liability of auditors.
5. How communication of audit finding to users can be improved to enable that information to be of more use.
6. The potential benefits and opportunities for international engagement and cohesion across the world on auditing standards.

The review will coordinate its work with the ongoing work of the FRC and will focus initially on the audit of Public Interest Entity companies whilst taking into consideration the effects on other relevant entities. It will also consider the proportionality of the balance in terms of cost to produce against benefits to the users in making recommendations.

#### **D. Context**

The present review is launched in the context of the Independent Review of the Financial Reporting Council which commented on the need for this review to be “driven by the interests of consumers and users of audited figures, not producers or the audit profession.” It is also launched in the context of the Update Paper, “Statutory audit services market study” published by the Competition and Markets Authority which commented on the need to clarify “what an audit is supposed to

achieve on a conceptual level and ... how audits might best serve shareholders (and ultimately the public interest).”

The government’s expectation is to see the UK at the forefront of corporate governance internationally. This includes maintaining a leadership position internationally in terms of the evolution of the audit.

## **E: Governance**

The review will be led by Sir Donald Brydon.

The Independent Reviewer will be supported by Advisory Groups that will advise on the direction of the review and sources of evidence and will help to scrutinise and challenge emerging findings and recommendations. It is anticipated that in addition to a user dominated group, there will be an audit profession group and a technology group, the precise structure of which remain to be determined.

## **F. The Review Secretariat**

The review will be supported by a small dedicated Secretariat acting in support of the Independent Reviewer.

The review is endorsed by BEIS, the Financial Reporting Council (FRC), the Institute of Chartered Accountants in England and Wales (ICAEW) and the Investment Association. The secretariat may therefore include secondees from the Financial Reporting Council, BEIS and members of the Investment Association, to ensure that the review has access to knowledge and expertise from the audit, accounting and investment professions.

The Institute of Chartered Accountants of England & Wales has also agreed to provide £500,000 of funding for use on the review.

All supporting organisations recognise and accept that their contribution to the review is unconditional. The review will be conducted on an independent basis.

## **G: Stakeholder Engagement**

The review will undertake engagement with a wide range of stakeholder groups in order to fully understand the range of issues, and ensure constructive challenge.