



CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

7 June 2019

Sir Donald Brydon
Brydon Review
Orchard 1, 1st floor
Department for Business, Energy & Industrial Strategy
1 Victoria Street
London
SW1H 0ET

By email: brydonreview@beis.gov.uk

Dear Sir Donald,

Submission on the Independent review into the quality and effectiveness of audit: call for views

We welcome the opportunity to contribute to the above call for views ("the paper"). We support the Review's focus on ensuring the audit process and product meets the needs of users and serves the wider public interest, and the pragmatic and wide-ranging approach indicated in the paper. This is a chance to look at the real issues, where audit can evolve and play an increasingly relevant role going forward. We strongly encourage international engagement for consideration of possible cross-border impacts and so that auditing globally may benefit from the Review's contributions.

We believe it is important to recognise the value and quality of financial statement auditing in its current form, and as mentioned in the paper to not discard what is good in the search for what is better. But we also agree that, with appropriate impact assessment, the time is right to revisit fundamental questions and look at how auditing could advance. Research we have recently conducted into public expectations of audit internationally indicates there is still confusion about the audit role, and the public want audits to evolve so it can play a greater role in tackling the risk of corporate collapses, fraud, and on environmental, social and governance issues.

The demand for reform in the United Kingdom has largely been driven by a series of high profile corporate collapses. Company failure does not necessarily equate to audit failure and audits cannot prevent all fraud or corporate collapses. There is scope for auditors to play an enhanced role in addressing fraud and corporate collapse, but this must be shaped in the context of the role played by all of the parts of the financial reporting supply chain. In particular it must be underpinned by greater rigor in the accountability and reporting of company management and boards, including for establishing an appropriate control environment to mitigate these risks.

Our submission aims to provide information and our views that we trust will be useful for the Review from an international perspective on auditing matters generally, and not pertaining to the United Kingdom or other jurisdictions specifically. We have set out our comments generally and cross-referenced where applicable to the questions in the paper.

Designing an upgraded audit – modular approach (Questions 7–8)

In revisiting scope and purpose, we believe the design of the desired assurance products and considering how they fit together from the outset is essential. The existing international auditing and assurance framework provides scope for the achievement of many of the extended objectives that are mentioned in the paper. An issue that may have exacerbated the expectation gap is that over time an ever-expanding set of objectives and expectations has been incorporated or assumed into financial statement audits.

A modular design approach would allow for clearly different components of assurance to be incorporated or excluded as appropriate for different entities and circumstances (eg a financial statement audit, controls attestation engagement, cyber-security review). This would aid in achieving clarity for the end user as to what comfort they can and cannot reasonably take from the audit and assurance work that has been carried out in a range of areas for any given entity. This approach could also help in avoiding possible cross-border inconsistency and impacts that would occur if extended scope, procedures, or reporting was incorporated into financial statement audits in the United Kingdom.

Scope and purpose

The paper raises several key areas where we agree the scope of auditing and assurance activities could be enhanced to further meet the needs of users and to serve the wider public interest. Most of these areas demand enhanced accountability and reporting by management and boards to effectively address the associated objectives and underpin assurance engagements, in addition to appropriate frameworks and liability settings for auditors. We also recommend the cost of any increase in the scope of auditing and assurance activities should be balanced alongside the potential benefits. This calls for carefully assessing which entities would be scoped in and the opportunity for post-implementation review and change where needed.

- **Internal controls (Questions 12–14, 39):** The internal control environment plays an important role in addressing the risk of fraud and in decision making by the management and boards of companies facing financial difficulties before they have reached crisis point. Additional rigor and accountability for company management and boards, with controls attestation by auditors, has been demonstrated to have significant positive impacts, for instance in the United States where financial statement quality and confidence has improved markedly since the introduction of such measures¹. With the appropriate underlying framework in place, auditors can play a valuable role in performing assurance engagements over the internal control environment and relevant assertions made by management and boards.
- **More graduated auditor reporting (Questions 25–26, 34–35):** While recognising the steps recently taken with the introduction of Key Audit Matters in auditor reporting, we agree there is value in further exploring how more graduated auditor reporting could add value for the users of financial reports. Transparency of the audit process and gaining greater value from the judgements and knowledge of the auditor underlay the development of Key Audit Matters. We recommend that financial reporting and other reporting by audit committees or boards may need to evolve to provide more nuanced

¹ Financial Restatement Trends in the United States: 2003-2012, <https://www.thecaq.org/financial-restatement-trends-united-states-2003-2012/>

information particularly around accounting estimates, going concern and other important judgements to underlay further meaningful extension of auditor reporting.

- **Assurance on information outside the financial report (Questions 21–22):** Analyst presentations, alternative or ‘underlying earnings’, and key performance indicators are increasingly the focus of shareholders and company stakeholders. There is scope within the existing international assurance framework for auditors to perform potentially valuable engagements on this information.
- **Culture audits (Question 55):** While organisational culture is highly intangible, the existing international assurance framework does provide scope for auditors to perform engagements that would provide independent insight into culture, provided there is an appropriate framework for reporting by boards, audit committees and/or management.
- **Technology and analytics (Questions 45–46):** New technologies that can aid in auditing and assurance activities are clearly developing rapidly and opening up new possibilities in processes and scope. However, the capacity for such technology to underpin notionally higher levels of assurance remains a work in progress and the limits of any technology must be recognised in order not to further exacerbate the expectation gap. We believe the Review can play a valuable role in supporting the development of new approaches through technology in auditing procedures and to issues such as detecting fraud.

Optimising how audit inspections assess and contribute to audit quality (Questions 6, 23–24)

Audit file inspections internationally provide valuable information for the profession and auditors on key areas to focus efforts in improving audit quality. The inspections influence the approach and focus of auditors in carrying out their work and the assessments reported by audit regulators have a substantial impact on how audit quality is perceived. Auditing is by necessity highly judgement and risk-based. We believe there is scope for audit inspections broadly to be optimised to capture the context of these judgements, and the outcomes of audit activities (eg reliability of audited financial reports, confidence in audited financial reports). This would provide a more accurate indication of quality and whether audit is working towards its objectives or not.

There is a risk of potentially adverse incentives and unintended impacts on auditing practice over time arising from file inspections that are overly focused on seeking compliance violations rather than looking at outcomes and regulatory objectives. This includes incentivising more compliance-based approaches to audit, while disincentivising appropriate risk-based approaches which are essential to continuing to deliver quality audited financial reporting.

Other information we believe may be useful for the Review

We have set out some further links and resources here that we believe may be relevant and valuable in relation to the Review:

- **Auditor liability (Questions 40–44):** The paper outlines several questions surrounding possible approaches to auditor liability, which we agree is a fundamental underpinning for auditors to play a role in a range of expanded scope and subject matter areas. A liability capping scheme, that has been shown to be effective, has been in place in Australia for some time. Please refer to further information here: <https://www.charteredaccountantsanz.com/member-services/being-in-public-practice/insurance-and-liability/liability-capping-scheme>
- **Public expectations (Questions 4–5):** Chartered Accountants Australia and New Zealand and the Association of Chartered Certified Accountants commissioned a survey into the Australian and New Zealand public's understanding and expectations of the audit profession, as part of a wider international study. Please refer to further information here: <https://www.charteredaccountantsanz.com/news-and-analysis/media-centre/press-releases/research-reveals-public-want-more-from-audit>

We would be pleased to provide further information or assist in any way that may be helpful as you continue this important work. The Appendix provides information about Chartered Accountants Australia and New Zealand and if you have any questions about our submission, please contact Amir Ghandar, Reporting and Assurance Leader

Yours sincerely

Amir Ghandar CA

Leader, Reporting and Assurance

Simon Grant FCA

Group Executive, Advocacy and Professional Standing

Appendix A

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 121,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over. Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.