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7 June 2019

For the attention of: Sir Donald Brydon

Re: Independent Review into the Quality and Effectiveness of Audit – *Call for Views*

Thank you for providing the opportunity to comment on your consultation document, dated 10 April 2019. Having reviewed the matters raised in your document I write to provide you with our comments, which have been reviewed and approved by our Audit Committee Chairman and Chief Financial Officer.

In addition to the overarching comments below, we have included specific responses to certain consultation questions in the Appendix.

We agree that there is an expectation gap between the current scope and purpose of an external audit, and what some users of the financial statements expect to be the case. However, we are not of the opinion that audit is fundamentally 'broken', and we also do not believe that changing the scope of an audit will solve all of the issues that have led to corporate failures and the need for the recent reviews.

Whilst we do not necessarily believe that the scope or purpose of an external audit should be amended significantly, we would recommend that further clarity is provided over certain areas to ensure that there is less room for misinterpretation.

We note that a number of matters under review are also covered in Sir John Kingman's Independent review of the Financial Reporting Council and the resulting BEIS initial consultation on the recommendations, as well as the final CMA report into the statutory audit services market. We observe that the findings of each should be considered in their wholeness. The comments in this letter should also be viewed in the context of those documents, and our responses to them where applicable.

We also note that further calls for views are expected in due course and we would welcome the opportunity to engage further on those topics.

Please do not hesitate to contact me if you have any questions or would like to discuss further.

Yours sincerely,

Ian Lawrence
Head of Financial Reporting
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Appendix: Response to certain specific consultation questions

Definitions of audit and its users	
Q1: For whose benefit should audit be conducted? How is it of value to users?	<p>If the audit, as currently designed, is of high quality it is of value to users as it provides assurance that the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with an applicable financial reporting framework. It is also of value due to the independent nature of this work, and the skills and experience of the auditor as a result of their work conducted for a wide range of clients. Rather than significantly changing the scope of audit, we believe it is critical not to lose sight of the core purpose of an audit and to ensure that core is done to a high standard with appropriate regulatory review. Ensuring quality should remain the priority, and not expanding the scope.</p> <p>As currently scoped, the independent external audit is primarily conducted for the needs of the shareholders and is not designed to respond to the requirements of all stakeholders. Whilst International Standards on Auditing state that the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements, they do not attempt to define those users. In the UK, for entities incorporated under the Companies Act, the auditor is currently required to report to the company's members because the audit is undertaken on their behalf. We believe that conducting an audit for the benefit of shareholders is appropriate.</p>
Q2: Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?	<p>We welcome measures to improve shareholders trust in companies, however we do not think that all information should be required to be subject to external assurance. We do not believe an audit should be designed to enhance the degree of confidence of intended users in an entity, as this would result in a scope that is far too broad and difficult to define and to regulate consistently. This would likely be a significantly different product from the audit as currently designed, and distinct from the issues that are trying to be addressed. External audit firms would not necessarily have the expertise and knowledge to be able to provide assurance of that nature. By requiring the design of an audit to enhance confidence in the financial statements, this can be clearly defined and regulated.</p>

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?

We believe UK Company law should explicitly define the meaning and purpose of audit and for whose benefit it is undertaken, as this would help to ensure that all those involved with the provision and use of statutory audit services have the same understanding. For example, the law should define who the expected users of the financial statements are in addition to shareholders. We also note that it would be important to consider any relevant changes in international law for consistency within multinational companies.

The 'expectation gap'

Q4: Do respondents consider there is an expectation gap?

Based on publicly available research and opinions, we do believe that there is an expectation gap between the current scope and purpose of an external audit, and what some users of the financial statements have previously expected to be the case. Whilst we do not necessarily believe that the scope or purpose should be significantly amended, we would recommend that further clarity is provided over the areas listed in paragraph 24 to the review to ensure that there is less room for misinterpretation.

The scope and purpose of audit

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

We would observe that the opportunity for the external auditor to take meaningful reliance on the work of internal auditors is often currently limited. It is our view that this could be increased and would welcome measures that would allow further reliance when appropriate criteria are met, consistent with the approach taken to reliance on other management experts.

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?

We would welcome measures to improve shareholder trust in companies, and our directors take their responsibilities seriously and are required to confirm certain matters through the statement of directors' responsibilities. We are broadly supportive of directors making a more explicit statement in this respect, but would want to ensure that there is clear guidance that is issued alongside any such requirement.

We would note that under existing standards, auditors should be considering certain controls, particularly over significant risk areas, and have the opportunity to refer to any relating areas of concern. We do not support the introduction of a requirement for auditors to be required to report publicly on internal controls as is done under the US regime as we do not believe that the benefits would outweigh the costs. Instead, it may be that more clarity should be given on what auditors are already

	required to do in this area.
Q13: Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified?	As above, we believe that auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be clarified but not extended.
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?	As noted, auditors are currently required to report to audit committees their views on the effectiveness of relevant internal controls for listed and other relevant entities. They are also required to summarise in the audit report how the most significant assessed risks of material misstatement have been addressed and will often refer to having tested specific internal controls. ISA (UK) 701 also requires "where relevant, key observations arising with respect to those risks" to be provided. The Call for Views states that the auditor's report does not usually include substantive commentary on the effectiveness or otherwise of relevant controls. However, we believe that auditors would provide commentary in the report if it was relevant and significant to the audit, and therefore there should be no further requirement for separate public reporting.
Q15: Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?	<p>It is our view that the regulatory framework relating to going concern could be enhanced. We believe it would be beneficial for companies to be more transparent in this area and provide more information in relation to how they have assessed the ability to continue as a going concern, including detail about the methods used and the key assumptions rather than just a statement.</p> <p>We also believe that auditor could perform work to verify that what has been done is in accordance with the method and assumptions disclosed.</p>
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?	It is our view that the auditing standards are currently very light on this area, with the requirement of the auditors being to consider consistency of the information only. We also believe that people may interpret the level of work that is required quite differently. We would suggest that this is an area of the auditing standards that requires more clarity, and may be of benefit to users if the appropriate level of work is performed over such information.
Audit product and quality	
Q25. What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?	We note that this matter is also covered in the Independent review of the Financial Reporting Council and the resulting BEIS initial consultation on the recommendations. We are of the opinion that careful consideration will be needed on the impact of

	<p>graduated audit findings to ensure that they promote positive actions from audit firms and improve the quality of audits.</p> <p>It is our view that “graduated” reporting of conclusions would be very open to interpretation by the reader as well as by the auditor in their choice of wording, and that consequently there is a risk that this could in fact result in less insightful, transparent and comparable reporting.</p> <p>We do not support the introduction of graduated reporting. However, if such a recommendation is implemented and the legislation updated, there should be a clear framework in place to ensure comparable and consistent reporting between both audit firms as a whole and the individual people signing those reports.</p> <p>We look forward to seeing the detailed consultation on this matter in due course.</p>
The communication of audit findings	
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?	<p>We would support the need for transparency to communicate to users of annual reports in areas of significant interest. However, we do not believe that an annual assurance meeting between auditors and stakeholders should be necessary if other processes are operating effectively. We believe it should be the responsibility of management and the audit committee to perform stakeholder management, and provided that the auditors are sufficiently effective and independent, the AGM should remain an appropriate forum for shareholders to raise any questions to the auditors if needed. If users of the financial statements would truly benefit from additional information from the auditors, this should be addressed through further defining or clarifying the addressees and requirements of the audit report.</p>
Q34. Should more of the communication and resulting judgements that occur between the auditor and the audit committee be made transparent to users of the financial statements?	<p>We support the desire for increased transparency in reporting and are open to enhancements that add value in an appropriate manner. However, we are not clear that this should be an additional requirement to the audit report, given that there is already a governance requirement for the Company to report on the work of the audit committee and the issues considered in relation to the financial statements.</p>
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?	<p>We would not have an objection to audit reports requiring an update on key audit matters that were present in the previous audit report. Indeed, we understand that this is already a feature of some audit reports and is helpful to understand the context of the</p>

	<p>current year key audit matters.</p> <p>However, as mentioned above it is our view that “graduated” reporting as has been suggested by some would be very open to interpretation by the reader as well as by the auditor in their choice of wording, and that consequently there is a risk that this could in fact result in less insightful, transparent and comparable reporting. We do not believe such a change should be implemented, as it would be difficult to ensure comparable and consistent reporting between both audit firms as a whole and the individual people signing those reports.</p>
Fraud	
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?	We do not believe that auditors should be given greater responsibility to detect fraud due to the forensic nature of the work and the level of detail that would be required to be sure to detect it. We do not believe that this is what the intended purpose of an audit is.
Q37. Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?	Under existing auditing standards, there is a mandatory (albeit rebuttable) risk of fraud in revenue recognition. We believe this can be potentially unhelpful as it is not always where the fraud risk will lie, and may divert audit efforts in the wrong direction.
Other issues - technology	
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?	<p>From our experience, we believe technology is likely to be used to varying degrees in different audits, although there would appear to be a significant movement by audit firms to move further towards a technology-based approach. Indeed, this was a prevalent factor in our recent external audit tender process. This is also likely to be driven by the increasing use of technology by companies and management themselves, and not just those perceived as being higher technology companies.</p> <p>It is our understanding that the increased use of technology should result in a higher quality and more insightful audit, which can properly focus on higher risk areas rather than ‘ticking the box’. However, this does not necessarily change the level of assurance that an audit firm can give, and we would caution further contribution to the expectation gap if users were to believe that 100% of the entity and its transactions had been assured by the external auditor.</p>
Other issues - shareholders	
Q52. Would interaction between	We would support the need for transparency and

shareholders and auditors outside the AGM be practical and/or desirable?

communication with shareholders and other stakeholders in areas of significant interest. However, we would highlight that we currently conduct a thorough stakeholder engagement process and engage in regular dialogue, therefore we are not of the belief that specific interaction between shareholders and auditors should be an additional requirement.

The AGM should remain to be an appropriate forum for shareholders to raise any questions or concerns to the auditors as needed. Further, if the nature of audit reports is appropriate and the issue of some being 'boilerplate' is addressed, we are of the view that there should be no need for additional dialogue.

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 that it should remain the responsibility of audit committees to approve planning matters for the audit, including scope and materiality. However, we believe that shareholders should also have the opportunity and confidence to raise any concerns about such matters at the appropriate time. It is our view that the AGM remains an appropriate time to raise any concerns, including directly to the external auditors, and that there should be no barriers to doing so. Shareholders could also engage with the Audit Committee chairman outside of this time if required, which could be done in writing. If a Company has strong governance procedures in place, an effective audit committee and independent auditors of sufficient competence, these should remain to be an appropriate forum and would be taken seriously. It is important that shareholders entrust the governance of the company to its committees and structures, as it would not be practical for it to operate any other way. It is likely there would be multiple opinions and often given without full context, which would be difficult to manage.