

Quality and effectiveness of audit

The AIC's response to the Brydon Review's call for views

The Association of Investment Companies (AIC) is a trade body for the closed-ended investment company sector. We represent 359 investment companies, holding assets of over £175 billion. The AIC's members are predominantly listed on the Main Market of the London Stock Exchange. Some have shares admitted to trading on the Specialist Fund Segment; others are quoted on AIM.

The AIC's members include investment trusts, Venture Capital Trusts, UK REITs and non-EU companies. Our non-EU members are usually domiciled in Guernsey and Jersey.

Operation and governance of investment companies

Closed-ended investment companies are collective investment vehicles which pool their shareholders' capital and hold a portfolio of assets to spread risk and generate an investment return. Investments include listed securities, private equity, debt, property and infrastructure.

Investment companies typically:

- Are operationally very simple, with limited or no physical presence.
- Have independent boards comprised of non-executive directors. The substantial majority do not have executive directors or employees and therefore do not have internal audit functions. Instead, they outsource the day-to-day running of the company to third party service providers. This includes appointing an investment manager to make the day-to-day investment decisions, and a custodian to hold assets that can be held in custody, such as equities and bonds;
- Do not provide goods or services and have no trading activity or customers. They are investment vehicles for their shareholders, but do not provide services to those shareholders;
- Have no turnover, so are not within scope of regulations such as the Modern Slavery Act 2015 or the Energy Savings Opportunity Scheme Regulations; and
- Have suppliers which are typically professional advisers or regulated firms.

Investment companies do not have complex group structures, international divisions or complex accounts.

The majority of investment companies report against the AIC's Code of Corporate Governance (AIC Code) which has been tailored to reflect the characteristics of the sector. The AIC Code is endorsed by the Financial Reporting Council as an alternative means for members to meet their obligations in relation to the UK Corporate Governance Code (UK Code).

Regulatory environment

The Alternative Investment Fund Managers Directive (AIFMD) places certain obligations on investment companies and their managers over certain size thresholds (this includes the majority of investment companies). These include:

1. Having a valuation of the investments performed by the Alternative Investment Fund Manager (AIFM), which may be the investment manager, or an external valuer at least once a year. The valuer is also required to have appropriate procedures so that a proper and independent valuation of the investment can be performed. The valuation function can only be performed by the AIFM if it is functionally independent from the portfolio management function and no conflicts of interest exist.
2. Appointing a depositary whose function it is to safeguard the assets of the company. The depositary must also ensure that the investment company's cash flows are monitored and payments, such as dividend income, are correctly received. For assets that are held in custody (e.g. equities and bonds) the depositary has strict liability for those assets and they must be segregated and kept in a separate account, so they can be identified as belonging to the investment company.

For assets that are not held in custody (e.g. derivatives, real estate and private equity instruments) the depositary must verify the ownership of the assets and maintain records of those assets. The depositary is appointed by the investment company, and it reports to the company.

3. Requiring the AIFM to have permanent risk management and compliance functions with adequate risk management controls, procedures and systems and review these annually. Where proportionate the AIFM must also have an internal audit function. The AIFM is required to have adequate systems in place to identify, manage, measure and monitor all the risks applicable to the investment fund strategy. These rules formalise the risk management process.

The requirements of the AIFMD provide the board and shareholders of an investment company with additional comfort regarding the valuation and ownership of its investments, along with the risks involved in its investment portfolio. This sits alongside the work the auditor performs.

Creating an effective reporting regime

The auditor reports to the shareholders of a company as the primary users of the financial statements and ultimate owners of the company. This does not negate the importance of other stakeholders in the company, but shareholders are, and should continue to be, the primary audience.

Audit is by its very nature a backward looking check on the company's financial statements. The AIC considers this to be a valuable assessment of historic transactions and events. This is well understood by shareholders and users of annual reports and accounts.

The scope of the work performed by auditors on the other areas of the annual report and accounts could be made clearer. This could be achieved by separating the annual report and accounts into two parts.

The AIC has long been concerned about the length and complexity of annual reports and accounts. We **recommend** a wider review of narrative reporting in the annual report and accounts is undertaken.

There is scope to improve the quality of reporting, reduce the volume of unnecessary disclosures, increase transparency for users and reduce the administrative and cost burdens placed on companies. This is vital as it is increasingly difficult for shareholders to extract key information and identify matters of interest from the disclosures in the annual report and accounts. Much of the relevant and current information is lost amongst 'boilerplate', mandatory disclosures.

To achieve this, the AIC **recommends** that the annual report and accounts be split into two parts:

- A 'strategic report' – This would be the principal disclosure for most shareholders. It would include the current Strategic Report or Management Report. It would provide a high level overview of what the company does and how it has performed in the period. It could also include more forward looking information. We envisage that it will also provide a clear signpost for shareholders of what additional information is available online and where it can be found.

This element would not be audited, but to ensure its credibility, the AIC **recommends** that it includes a report from the auditors confirming that the information is consistent with the 'historic report' (see below). This should not create a significant increased time or cost burden as the auditors already carry out this review as part of their audit work.

- A 'historic report' – This would include other information from the current annual report and accounts, including the directors' report, corporate governance statement, directors' remuneration report, statement of directors' responsibilities, and the full financial statements. This would be published online. This element would be backward looking.

The AIC **recommends** the current sections of this element that are audited, remain subject to audit. As currently required, the auditors will also read the other areas of this report and identify whether the other information is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit, or otherwise appears to be materially misstated. If the auditor identifies such material inconsistencies or material misstatements, it must disclose this in its report, if the matter is not rectified by the company before publication.

This could significantly reduce the length of the material sent to shareholders. Most notably as the detailed figures in the financial statements will be online. Any investor requiring these disclosures could easily go online to get the information they require. This approach does not diminish the information provided to shareholders. Instead, it ensures that investors get the disclosures which meet their needs in a digestible and accessible format.

Having a 'strategic report' as a separate document will allow readers to make a quick assessment of the company's activities and developments rather than having to consider a much longer document. It could also provide better information about the company's intentions for its future.

This proposal will significantly enhance the quality of reporting not only to shareholders but also for other users of the annual reports and accounts. It will also help to clarify that the auditors focus is on the 'historic report'.

Chapter 1 – Definitions of audit and its users

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

An audit should be primarily for the benefit of the shareholders of the company. The shareholders ultimately pay for the service and auditors report directly to the shareholders.

As stated above, the AIC considers audit to be a valuable assessment of a company's historic transactions and events. This gives shareholders and other users of the financial statements confidence in the profits/losses and financial position of the company. This in turn, provides confidence in the market.

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

Please see the section "Creating an effective reporting regime" above.

The AIC **recommends** that audit be designed to enhance the confidence of shareholders as the primary users of the financial statements.

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?

Please see the section "Creating an effective reporting regime" above.

The AIC **recommends** that that UK law is amended to clarify that audit be undertaken for the benefit of shareholders.

Chapter 2 – The 'expectations gap'

Q4. Do respondents consider there is an expectation gap?

Yes. This is in part due to the annual financial report and accounts being used for an increasing amount of information. This has made it unclear as to which parts of it are audited and what an audit actually does.

As set out in the section “Creating an effective reporting regime” above, the AIC **recommends** the annual report and accounts be split into two parts. This would make it easier for users to understand what has been audited and what has not.

For example, the “Call for views” identified that there is an expectation that the audit will provide assurance over the sustainability of an entity or its business model. Under the AIC’s proposed model, this information would be included in the ‘strategic report’ which would not be audited.

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

The AIC has no comment on this question.

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 AIC has no comment on this question.

Chapter 3 – Audit and wider assurance

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

Increasing amounts of information is being made available about companies. This not only consists of information published by companies themselves, such as their financial statements, regulated disclosures, broader information about their strategy and business model, but also analyst reports and wider media comments.

It is untenable for auditors to audit this increasing wealth of information and it leads to confusion about what auditors do and what information they provide an opinion on.

The AIC **recommends** that statutory audit focuses on reviewing the financial statements and other information required to be audited contained in the ‘historic report’ as set out in the section “Creating an effective reporting regime” above. The auditors would read other information not required to be audited in the ‘historic report’ and the ‘strategic report’ for consistency.

Where companies, shareholders or wider stakeholders demand more assurance on other areas, this can be provided by reporting accountant, or other appropriate consultant, based on a defined and agreed scope. Different levels of liability could also be agreed with the reporting accountant or consultant.

It is important for companies to be able to choose the most appropriate consultant to provide the assurance required. For example, an auditor may not be the most appropriate person to provide assurance on the IT controls at a bank or derivatives trader. Instead, perhaps a specialist IT firm would have more experience and knowledge in that field.

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?

No, the overall assurance that is provided by the auditor should remain consistent for all statutory audits.

However, certain other factors will affect the amount of work that needs to be performed to attain the required level of assurance. For example, the size, nature and complexity of the company, including the sector it operates in. Additionally, the level of materiality should be set on an individual company basis and that too will impact the amount of work that needs to be performed to attain the required level of assurance.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

Chapter 4 – The scope and purpose of audit

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?

No. The AIC does not consider that there is a sufficient case for adopting a strengthened framework around internal controls on a similar basis to the Sarbanes-Oxley (SOX) Act in the United States.

The Kingman Review states that introducing SOX-style provisions could “*impose significant costs, at least initially, particularly on smaller listed companies. The US experience shows that smaller companies are affected disproportionately and listing could become less attractive.*”

The requirements of SOX have been widely criticised for being overly burdensome and costly to comply with, particularly for smaller companies. It has created unnecessary processes and procedures which are ‘tick box’ in nature, requiring extensive paper/electronic trails to evidence that processes and procedures are appropriately followed.

SOX requires companies to implement internal controls and processes to ensure the accuracy of reported results. It mandates a set of internal procedures to achieve this.

There is no evidence that these procedures provide material, additional shareholder protection nor protect the wider public interest. These measures focus on administrative processes and increase the burdens of companies without improving the quality of the systems in place. There is a real risk that issues are lost in a blizzard of routine administrative and sign off procedures.

In the UK the Companies Act already requires “*reasonable accuracy*” in annual reports and accounts. It provides that:

- Every company must “*keep adequate accounting records*” that are sufficient to “*show and explain the company’s transactions*” and “*disclose with reasonable accuracy, at any time, the financial position of the company at that time*”;
- Directors of a company must not approve accounts unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss;
- The auditor of a company must have regard to the directors’ duty as set out in the bullet point above.

Additionally, the UK Code states that the board should present a fair, balanced and understandable assessment of the company’s position and prospects (Principle N). Furthermore, the directors should explain in the annual report their responsibility for preparing the annual report and accounts and state that they consider the annual report and accounts, taken as a whole, to be fair, balanced and understandable (Provision 27).

The UK is not prescriptive about how companies implement internal controls to achieve “*reasonable accuracy*” in their annual reports and accounts. Instead further guidance is provided by the FRC in its 2014 Guidance on Risk Management, Internal Control and Related Financial and Business Reporting paper.

Additionally, the UK Code states that:

- The board should establish procedures to manage risk and oversee the internal control framework (Principle O);
- The audit committee, or similar, is responsible for reviewing the company’s internal financial controls and internal control and risk management systems (Provision 25);
- The board should monitor the company’s risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. This should cover all material controls, including financial, operation and compliance controls (Provision 29).

Companies subject to the FCA's Disclosure Guidance and Transparency Rules (DTR) are also required to include "*a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process*" in their corporate governance statement (DTR 7.2.5).

SOX rules inappropriately prioritise process over outcomes. The UK has a superior system. Recent problems in auditing and accounting reflect a failure to maintain the high standards that are already in place. Implementing SOX type rules with a focus on process and procedure will not necessarily prevent similar issues in the future.

The AIC **recommends** that existing UK provisions are sufficient to provide that companies report on the effectiveness of the company's internal controls in relation to financial reporting. This framework recognises that companies may have different approaches to internal controls based on the size, nature and complexity of their business.

However, where companies, shareholders or wider stakeholders demand more assurance on internal controls and risk management, this can be provided by a reporting accountant, or other appropriate consultant, based on a defined and agreed scope. Different levels of liability could also be agreed with the reporting accountant or consultant. For example, investment companies may receive assurance reports on the internal controls of their service providers performed in line with the Technical Release "AAF01/06" published by the Audit and Assurance Faculty of the Institute of Chartered Accountants of England and Wales (ICAEW).

The AIC **recommends** that if any further consideration is given to strengthening a statement in respect of risk management and internal controls it should utilise the UK's current framework and the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting paper, rather than considering prescriptive and onerous SOX-style provisions.

The AIC **recommends** that implementing SOX-style provisions in the UK would be especially harmful and disproportionate for smaller companies, including investment companies.

The AIC also **recommends** that any further consideration of implementing SOX type rules should consider the concerns set out in the Kingman review regarding imposing significant costs and disproportionately affecting smaller companies. Unless these problems are addressed, SOX type rules should not be implemented.

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

No. The current requirements are sufficient. Auditors do not have to rely on a company's internal controls when performing an audit. Furthermore, there is no evidence that audit committees do not act on the deficiencies that auditors bring to their attention.

See our response to question 14 below for more detail.

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?

No. The requirement set out in the auditing standards is that the auditor “*shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance...*”. The requirement is only in relation to internal controls that have been considered or used as part of the audit.

Additionally, auditing standards state that for companies reporting against the UK Corporate Governance Code, the auditor shall communicate to the audit committee the auditor’s views:

*“without expressing an opinion on the effectiveness of the entity’s system of internal control as a whole, and **based solely on the audit procedures performed in the audit** of the financial statements, about:*

- i) The effectiveness of the entity’s system of internal control relevant to risks that may affect financial reporting; and*
- ii) Other risks arising from the entity’s business model and the effectiveness of related internal controls to the extent, if any, the auditor has obtained an understanding of these matters”. [Emphasis added]*

The review of internal controls is one element of the auditor’s work. Understanding the internal controls of a company helps auditors to plan and conduct their work. It particularly helps them to assess whether they can rely on the internal controls and therefore take a more controls-based approach rather than a substantive approach to their audit work. However, there is no requirement to rely on a company’s internal controls and therefore they may not be reviewed in detail.

Were auditors required to report publicly their views, this would create an expectations gap, whereby shareholders would consider that the auditors were giving an opinion on all the internal controls within a company, rather than on specific areas that they have identified “*solely on the audit procedures performed*”.

Additionally, there is no evidence that audit committees do not act on the deficiencies that auditors bring to their attention as required by the current auditing standards.

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

The AIC has no comment on this question.

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”?

The AIC has no comment on this question.

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 already requires boards to explain how they have “assessed the prospects of the company”. If the board had material concerns about the sustainability of the company’s business model, this would be captured within the viability statement.

Q18. Should such a statement be subject to assurance?

No. The current ‘read requirement’ to assess whether information contained in the annual report and accounts is materially inconsistent with the financial statements or the auditor’s knowledge obtained during the course the audit is sufficient to assess the directors’ statement on viability.

Increasing the scope of the assurance provided by the auditor to cover a viability statement would significantly increase the cost of the audit, without providing any significant benefit to shareholders and users of the accounts.

Please also see our response to question 20 below.

Q19. Who might be capable of giving such assurance?

The AIC has no comment on this question.

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

No, as stated above, audit is by its very nature a backward looking check on the company’s financial statements. It is a valuable assessment of historic transactions and events. This is well understood by shareholders and users of annual reports and accounts.

As set out in the section “Creating an effective reporting regime” above, the AIC **recommends** the annual report and accounts be split into two parts. This would make it easier for users to understand what has been audited and what has not.

Where companies, shareholders or wider stakeholders demand more assurance on other areas, for example more forward looking statements, this can be provided by reporting accountant, or other appropriate consultant, based on a defined and agreed scope.

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?

If there is a demand for audit or other assurance to be provided on any particular aspect of a company, then this can already be done.

The AIC **recommends** that any other information in the annual report and accounts, or elsewhere, is not mandated to be subject to audit or another form of assurance.

Please see our response to question 20 above.

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

Please see our responses to questions 20 and 21 above.

Chapter 5 – Audit product and quality

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

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC **recommends** the audit opinion itself remains binary. That is to say the financial statements either provide a true and fair view of the company’s position and performance over the period, or not. Albeit the audit report itself may or may not contain graduated disclosure of auditor conclusions against the auditors’ key audit matters and its assessment of risks of material misstatement.

It is important for users of financial statements to be provided with a clear audit opinion rather than having to interpret a subjective narrative.

Q27. What would prevent such disclosures becoming boiler plated?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

Chapter 6 – Legal responsibilities

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?

The AIC has no comment on this 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?

The AIC has no comment on this question.

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

The AIC has no comment on this 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?

The AIC has no comment on this question.

Chapter 7 – 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?

No. In many cases, shareholders already have an opportunity to engage with the audit at the AGM. Yet it is rare for questions to be put to the auditor at an AGM. It is unlikely that many stakeholders would engage with an auditor if given the opportunity.

An annual assurance meeting would also create liability questions in relation to the auditor responding to a third party stakeholder in relation to the audit it is contracted to perform by the company on behalf of its shareholders.

If auditors were to have any duty to report or discuss matters concerning their audit directly with stakeholders it is likely to substantially increase the costs of an audit which would ultimately be borne by the shareholders of the company.

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?

No. The AIC considers that public reporting on communications and judgments is not always appropriate.

For example, auditors may have debates with audit committees throughout the audit about a certain matter. These private discussions may shift the activity or behaviour successfully and may prove to be a more effective method to engage more fully on issues. Were public reporting always to be expected, it may entrench positions, create unnecessary conflicts or encourage people to act defensively.

Ultimately, if an auditor disagrees with a company on a certain matter that materially affects a balance or considers the annual report and accounts to be misstated or has been unable to form an opinion, then a qualified, adverse or disclaimer of opinion may be provided.

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?

The AIC has no comment on this question.

Chapter 8 – 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?

As set out in the auditing standard dealing with “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. The responsibility of the auditor is to obtain “*reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error*”.

The AIC **recommends** these responsibilities remain unchanged.

Were auditors to be given greater responsibility to detect material fraud, the costs of the audit could rise exponentially and in many cases, there will be no clear benefit to shareholders.

There will always be an inherent risk of fraud arising in companies and this is particularly hard to detect where there is collusion. To help address this, if there is demand from companies, shareholders or stakeholders, companies could engage a reporting accountant or other appropriate consultant on an ad hoc basis to review certain parts of their businesses where there are increased concerns in relation to fraud. This could include reporting on a company’s systems or other internal controls in place to detect or prevent fraud.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

Please see our response to question 36 above.

Chapter 9 – Auditor liability

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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. This would substantially increase the costs of an audit which would ultimately be borne by the shareholders of the company.

Currently shareholders indirectly bear the cost of the audit and receive the benefit of the auditors reporting to them. If auditors were also made potentially liable, or otherwise accountable, to all stakeholders, the costs to the shareholder would increase, but the benefits would only accrue to the other stakeholders. This is not fair or proportionate.

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?

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

Chapter 10 – Other issues

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?

The AIC has no comment on this question.

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 AIC has no comment on this question.

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

The AIC **recommends** that statutory audit focuses on reviewing the financial statements and other 'historic information' as set out in the section "Creating an effective reporting regime" above.

This would give clear boundaries to what auditors provide assurance about.

Additionally, the AIC **recommends** that the financial statements only contain information that is required by company law or accounting standards. Other regulatory disclosures the companies are required to make should not be included within the financial statements. This will further help to provide clarity over the role of the auditor.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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?

The AIC **recommends** that statutory audit focuses on reviewing the financial statements and other 'historic information' as set out in the section "Creating an effective reporting regime" above. Therefore, there would be no extension to the scope of the audit.

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?

The AIC has no comment on this question.

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

In many cases, shareholders already have an opportunity to engage with the audit at the AGM. Yet it is rare for questions to be put to the auditor at an AGM.

Were companies required to facilitate interaction between shareholders and auditors outside of the AGM, this would create a significant administration burden without any significant benefit.

The AIC considers this is not practical or desirable and it will not provide a significant benefit to shareholders.

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?

Currently, many shareholders do not actively engage with the company about key issues relating to the operation of the company. Therefore, it is difficult to believe they will engage in matters relating to planning an audit.

In many cases, shareholders will not have a detailed knowledge about the operations of the company nor will they possess accounting knowledge. The AIC considers that the auditor and the audit committee is best placed to plan and approve the audit scope and materiality.

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

The AIC has no comment on this question.

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

The AIC does not consider auditors should report on the culture of an entity. In general, the auditor only sees part of a business. The board is in the best position to promote, monitor and assess the company's culture. This is already recognised in the UK Code which states:

“The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The annual report should explain the board's activities and any action taken.”

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

The auditor can demonstrate this throughout the audit process. For example, this can be demonstrated in the initial planning document sent to the audit committee setting out the work it intends to carry out and detailing the areas of focus and challenge it intends to apply in each area. This can also be demonstrated in conversations throughout the audit with management and the audit committee and at the end of the audit when it reports to the audit committee.

Following professional auditing standards will also help to demonstrate appropriate scepticism.

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

The AIC has no comment on this question.

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

Audit fees are commercially agreed and subject to market forces.

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

No. For companies other than small and medium size companies, the annual report and accounts must disclose the amount paid to the auditor for auditing services and the amount for non-audit services. This should be split between the different types of services provided (for example, tax, internal audit and other services).

The AIC **recommends** that no further details be required. This would increase the length of the annual report without providing any significant benefit to users.

If companies have sufficient demand from shareholders to have further details about the make-up of fees paid to the auditor, including more information about the audit fees, companies may wish to provide this, but it should not be mandatory.

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

The AIC has no comment on this question.

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