Brydon Review
Orchard 1, First Floor,
Department for Business, Energy & Industrial Strategy,
1 Victoria Street,
London,
SW1H 0ET

10 May 2019

Dear Sir Donald,

In your call for views dated 10 April 2019, you pose a number of questions in relation the quality and effectiveness of audit. Key among them is the purpose of audit and for whom should it be carried out. In seeking to answer this question, one necessarily needs to address many of the other questions you raise.

The present audit

The present audit is essentially an early 20th century solution to the need to provide investors with independent assurance that a company's published financial information is both trustworthy and reliable. The solution of the time was (and remains) a terse and limited opinion issued by an independent auditor anything up to nine months following the balance sheet date.

The principle of an independent assessment of the trustworthiness and reliability of an organisation's published financial information remains valid. In our view, however, the scope of information to be disclosed and the approach to providing such independent assurance needs to change with the times, as does the form of the assurance.

Audit scope

We suggest the answer is to replace the existing audit opinion statement with a fuller due diligence style assurance report (possibly as a separate accompanying document to the annual report) that would require the external auditor to consider and comment on a broader range of questions affecting the company, including for example[1]:

- the quality and reliability of the company's financial statements
- the continued relevance of the organisation's business model, corporate strategy and its prospects
- the principle risks facing the organisation and the effectiveness of its risk management and internal control arrangements
- the organisation's culture, values and principles
- the overall quality and ability of the senior management team.

This type of document is already used and valued by investors when considering questions on acquisitions, mergers and other corporate actions. Moreover, auditors have the experience and capability to produce due diligence type assurance reports already.

The benefits of this type of assurance (rather than audit) reporting would be substantial. For example, it would provide investors and other key stakeholders with the ability to 'compare and contrast' management and auditor views on the company's current and likely future performance and any associated risks.

1 There may be sensitivities about publicly disclosing certain information that would typically be disclosed in a limited circulation due diligence report. We feel, however, that mechanisms already developed for European Banking Authority Pillar 3 disclosure reporting provide a workable solution to this challenge. For example, commercially sensitive information may be withheld by the auditor where considered necessary, but the fact it has been withheld would be disclosed.

Halex Consulting Limited 86-90 Paul Street / London / EC2A 4NE
T +44 (0)20 3823 6569 E enquiries@halex.uk.com W halex.uk.com

Additionally, due to the level of detail typically associated with this type of assurance reporting, investors would be better able to assess and challenge the quality of the auditor’s work – something that is not possible under the current approach.

We believe this approach would also lead to a better alignment of interests between investors and external auditors through increased transparency as described above. Additionally, it seems likely that a healthy tension would develop between senior management and the external auditor as the increased scrutiny associated with due diligence style assurance reporting begins to take effect.

Interestingly, this style of assurance reporting may also increase tensions between the board and auditor, particularly where views diverge on key topics such as the organisation’s business model and corporate strategy. Again, investors may appreciate boards being challenged in this way.

Auditor fees and professional liability

It is likely that such a change in auditor reporting would significantly increase the time and quality of resources needed to conduct the work, leading to a substantial increase in auditor fees. Such an increase in auditor fees may be unpalatable, but even a large increase in fees is likely to immaterial to the organisation’s overall performance.

Auditors may express concerns regarding increased exposure due to the more extensive and expert opinion-based nature of due diligence type assurance reports. However, in our view, any increased exposure should encourage increased auditor focus on the quality and reliability of their work and should further reinforce the alignment of investor and auditor interests.

Timeliness of audited information

In our introduction we note that the existing audit opinion can be issued anything up to nine months after the balance sheet date. In a world of instant access to information, an audit opinion on nine-month-old financial information is next to valueless.

In our view, companies and their auditors need to examine ways in which non-contentious / non-judgemental financial and other corporate information can be put in the public domain more quickly.

Distributed ledger technology (e.g. Blockchain) may provide a means for real-time auditing of basic (transactional) financial information in future. European Banking Authority Pillar 3 reporting sets a precedent for published disclosures to be updated as frequently as may be helpful to the market - for example quarterly.

In terms of our proposal for a due diligence style assurance report, we see no real reason why it couldn’t be formally published annually with key elements updated quarterly thereafter. This would provide for the auditor’s work to be spread more evenly over the course of a year and time-sensitive information updated more frequently.

In summary, we believe the UK has an opportunity to significantly enhance the quality, reliability and value of corporate (rather than just financial) reporting and auditing through embracing radical change and leveraging technological developments where appropriate. The Brydon Review should be central to making this case.

Sincerely,

Christopher Burt

Principal, Halex Consulting Limited

Original concept and principal author, the Risk Guidance Initiative (www.theriskcoalition.org.uk)