Brydon Review

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Responses to call for views.

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

The benefit should primarily be to those uses who have some form of current legal association with the organisation being audited (i.e. Investors, debtors, creditors, providers of finance etc), additionally the benefit is also extended to similar parties who are using the audited financial statements as a basis to form any form of investment or other legal association with the audited organisation.

The value is that a third party professionally regulated view on the financial statements has been formed and reliance is placed by those parties mentioned above as a basis to make any decision in relation to their association with that organisation.

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

Yes, the audit should extend to provide not only a view on historical reported information, but also to provide confidence in the management team and management of the organisation being audited. It is important for the wider public that audit sign off can instil confidence that the firm is a going concern.

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?

Yes, It should be amended to ensure that those parties with a current connection with the organisation are those for whom the audit is conducted, however inclusion of users basing potential investment decisions on those audited financial statements should also be considered. Clarity should be provided as to the limitations of the audit for those potential investors to avoid invalid/unsupported negligence claims being made.

Q4: Do respondents consider there is an expectation gap?

Yes.

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

Auditors have historically been seen as the organisation that ensures organisations report accurate information in annual reports, that the stewards of the company are trustworthy and have implemented controls and procedures to protect anyone with a valid interest in an organisation. Additionally, the auditors (from a wider audience perspective) are thought to ensure 'everything' is correct including the uncovering of fraud.

Basically, the auditor is still perceived to 'police' and audited organisation.
A more nuanced understanding of the audit 'expectations gap' will help to explain some of the challenges. Ultimately, an open and accountable discussion with all sides needs to take place. Mills and Bettner (1992) who highlighted 4 different gaps is a good starting point in terms of different levels of expectation gap.

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?

Yes, auditors are under immense pressures from both clients and their own internal targets. As a result, there is the potential for premature sign off of working papers whereby insufficient work has either been conducted or documented to address the relevant ISA. Reduced corporate reporting periods additionally impact on this whereby pressures on auditors to conduct and sign off the audit exist to meet external reporting deadlines. Although evidence exists whereby stronger auditors refuse to prematurely sign off an audit area weaker auditing firms appear to be still under pressure from their clients to meet their own reporting deadlines thus adversely impacting on the quality of the audit.

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

Not purely to opine on the annual report and financial statements, but extend to the performance of those entrusted by the associated individuals to operate an organisation on their behalf, including an appraisal of the decisions made throughout the reporting period.
The external audit can be developed further, not just a compliance activity, but as a central driver in the management approach within the business, including the internal audit system and the corporate governance process.

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?

Yes, the opinion and audit process to be adjusted to reflect the size and nature of an organisation (i.e. an owner managed organisation). Additionally, using a traffic light system in a similar way to charity / internal audit reports as an additional guide as to the level of perceived risk and the auditor's response to those risks.
Whilst the general external audit approach is one built on operational systems and regulatory frameworks, all audits must be specific to each business and context. The specification of the audit is a central part of the legitimacy of the audit process

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

No, other than those more senior/experience staff within an organisation the roles and responsibilities are not clear. For the wider audience external to the organisation few know the distinction between these roles.
The relationship between the internal and external auditors needs to be carefully and clearly defined, the converges in approach and differences of the two systems.

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

This is an invaluable source of audit evidence for the external auditors, however where an internal audit function is not outsourced to an external provider that internal auditor evidence may not be deemed to be as independently sourced/reported upon as that from an external provider. Although independence with an internal auditor is deemed to be a necessity, it is worthy of note that internal auditors who are employees of their audited organisation could be deemed to be less independent (and thus less reliable in terms of conclusions drawn) than those externally sourced.

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?

Independence is a key requirement of any auditor. The audit and auditor rotation guidelines that are centred on maintaining 'independence' can be reviewed in terms of the unintended consequence of allowing the tacit business knowledge of the current auditors to be lost in moving towards independence through audit(or) rotation.

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?

Yes and yes, everything within the annual report should be subject to audit.

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

Yes, the work on controls should be extended as some smaller audits take a purely substantive approach where it is deemed to be more cost effective to do so and the control environment is not assessed. Reports as to how this has been done should be made publicly available within the annual report. Greater disclosure on the responsibility of the directors in respect of internal controls should be included within the annual report.

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?

Yes, although ISA 260 requires reports to those charged with governance, those matters that arose during the audit can be available in the same way as an annual report.

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

Yes, the regulatory standards clearly cover going concern issues but a repositioning of the audit approach can help, from just approving and signing off the audit to an approach where support guidance and advice should help firms in the first place from failing.

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”?

Yes, additionally the auditors should be including within the annual report how an organisation going concern opinion has been arrived at.

Q17: Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?

It appears to be adequate.

Q18: Should such a statement be subject to assurance?

Yes, everything within the annual report should be subject to audit

Q19: Who might be capable of giving such assurance?

The appointed external reporting auditor

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

There appears to be a case and this builds on the going concern reviews, however exactly how that could be undertaken could prove challenging as it is doubtful that any auditor would make any opinion based on predictions, however a full audit of any interim information that has been released post year end to the date of the signing of the audit opinion may be beneficial.

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?

Yes, all reported information should be subject to audit scrutiny.

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

As above, as reliance placed on any 'audited' information by any user will enhance the 'comfort' taken from those audited disclosures.

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

Yes, as depending upon the size and type of organisation, the product (essentially the audit opinion) is the same. However, the audit process in delivering that process should be made applicable to the organisation being audited as it is felt that there are too many regulations/ISA's for smaller non-listed organisations.

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?

Yes, ensuring files are complete as opposed to quality occasionally shifts the focus of the auditor to merely tick a box as opposed to ensure quality is delivered.

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

Emphasis of various matters

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

Yes, additional information in relation to the management team of the organisation and how they have performed throughout the audit process. Additionally any information in relation to (if the audit has overrun) what has caused an over run and additional costs incurred in completing the audit.

Q27. What would prevent such disclosures becoming boiler plated?

Management of organisations would be averse to having anything made publicly available that could include any adverse opinion / commentary upon which they/their organisations could be judged. A process of accountability within the audit process

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

The standards have become too cumbersome and not suited to all audits/organisations. The time taken completing / adhering to such mandatory standards by auditors reduces the amount of time that could be dedicated to individual clients whereby bespoke procedures could be developed.

Audit quality is not about just completing the perfect audit file, but also about adding value and does not always translate perfectly in terms of following prescriptive standards.

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 auditor has the responsibility to ensure any laws and regulations are adhered to and these should be mandatory procedures in any audit. As previously mentioned, all matters that arise during the audit (unless clearly insignificant in nature/size) should be made available to any associated/interested party via the financial statements audit opinion or via and auditors findings report.

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?

A clear explanation should be made available either within the financial statements or via a link provided within those statements to an external explanation.

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

Yes

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?

This is if the auditors are able to access everything they need during their audit, however where information has not been readily available, or information requests prolong the audit then additional overruns will be incurred. The result is usually additional costs being incurred by organisations. It has been noted that organisations are in favour of additional disclosures within the audit report / annual report on how prepared they were for the audit and any additional costs also being disclosed within the audit fee disclosure notes. With such additional disclosures this could add value as to the adequacy (and availability) of not only accounting records, but also annual report and financial statements supporting documentation and explanations.

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?

It would add value, however as interested parties may be globally located the timing and location may prove difficult for all to attend. Using technology either on-air web-based meetings could help to capture the challenges of widespread stakeholder engagement.

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?

Yes. With links to reports made available within the financial statements. To engage with more stakeholders in a digital era additional approaches to communication can be used including: podcasts; blogs.

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?

Yes, follow up work on previous years findings is a part of current audit procedures, it would be beneficial to interested parties to be informed as to how these have been addressed by the organisation since the previous reporting period end.

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?

No, there remains a gap in users' expectations, ideally auditor's responsibility could be extended, however this would mean additional time would be required to conduct these procedures and thus increasing audit costs. However, it must always be at the forefront of any auditor and subsequent users of audited information that detection risk will always remain and thus frauds may remain undetected.

It is vital though that the current discussions between the regulatory bodies and the wider public (mainly played out through the media) are allowed to develop further to bring closer together the two main groups (regulators v public) that have traditionally held separate and unbridged views of the audit process in relation to the location of fraud.

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

No, the focus of the auditor is purely compliance as opposed to adopting a more challenging approach to fraud.

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

Yes

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

Yes.

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

Yes, auditors will always focus on minimise their risk and exposure to any litigation/negative comments.

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

Depending on the size of the liability there could potentially be an adverse impact on the quality of an audit. If a potential liability was deemed to be relatively insignificant this gives rise for a lower quality, less efficient and effective audit to take place thus giving rise to an audit opinion with limited value.

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?

Yes, as this would make auditors more diligent in their work and documentation.

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?

Quality may be improved if the liabilities were revisited, however a financial penalty my not be the best deterrent (although significant). Where individuals with the signing responsibility may suffer internal adverse effects more personal/individual direct implications could act as a greater deterrent and thus promote quality as being paramount. A suspension/removal of an auditing license for the signing auditor and also the review of individual on the audit teams professional memberships could focus the audit team as a whole on providing and documenting a quality audit.

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?

N/A

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?

For the larger auditing firms yes, smaller firms are unable to invest in technology to the same extent. Technology is proving to aid the audit in terms on making enquiries within organisations accounting systems themselves, but this does not negate the need for ‘traditional’ audit tests. However as for the recording and documenting of the audit this is only as good as the information provided and subsequently recorded and concluded upon.
This has to be kept under constant review, a challenge is with the speed of change in terms of the digital development within the business community, the regulatory systems in particular will lag behind and slow down the effective use of new technology.

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?

Technology is enhancing the larger audits and those global audits, however it is still in its relative infancy. In one sense though, the increase in technology can help with the more complex large firm audit process, but also be able to be used and plugged in to making a more efficient assurance approach in smaller firms.

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

It is felt that too much emphasis is placed on the audit planning and audit completion phases of the audit thus reducing the amount of time actually ‘doing the audit fieldwork’ where the substantiation and verification of relevant account balances and disclosures is conducted.

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?

Greater emphasis on the going concern review conducted prior to the signing of the financial statements. A 'mini' audit of the most recent post reporting period end results could be conducted.

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

Not at the top end where large organisations pay multi-million-pound fees as the providers account for a significant amount of fee income, although lower than statutory fee income limits there could be seen to remain a potential threat to independence. Reviewing the fee income thresholds could attempt to alleviate this however where organisations consistently receive clean audit reports the audit will remain to be seen as an unavoidable overhead with little audited organisations senior management 'buy-in' to the process.

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?

An audit (as mentioned above) is deemed to be an unavoidable overhead, as a result it should be treated as a form of 'taxation' on an organisation without the possibilities to defer/avoid the cost in the same way as a normal taxation charge.

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?

Audit reports are generally not read in their entirety by not only shareholders but any user of the annual report and financial statements. The majority of users flip to the opinion to see if it is un-qualified and then read any modifications if any exist. All the caveats within the audit report tend to be skipped over. AI could paly a large role within the analysis or audit reports, analysis could uncover the number of (for example) modifications per audit firm or by organisations size and type, or where there is a common director etc and this may highlight risk organisations / directors etc.

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

Definitely as this would provide the auditors with the opportunity to provide shareholders with current issues/challenges facing the business as well as technical updates in relation to annual reporting. Additionally shareholders could share any concerns they had about the business/management team and this would give the auditor the opportunity to incorporate those concerns into their audit planning , audit testing and subsequent reports to those 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?

The audit plan, scope and materiality should be shared, this will provide the shareholders with the opportunity to understand the audit work being proposed as well as allowing input (as per Q52) into the audit tests. Materiality is the auditors assessment of essentially errors/matters they are willing accept although shareholders may be less willing to adopt an audit approach where materiality is deemed to be to high to meet their desired levels of assurance.

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

Shareholders have 'reasonable' assurance from an audit report in its current format, however assurance levels have been tested recently with the number of corporate scandals/collapses and the increased focus on the audit profession as a whole.

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 audit being extended to include a qualitative approach to interviewing senior members of staff and a qualitative approach to more junior members of staff at all levels throughout the organisation. However, the reassurance of anonymity of such reporting must be adhered to, to avoid biased results being received from employees to ensure their individual views did not impact on their current role and employment security. Including such additional work would increase the audit fee and may not be deemed to be of value to providers of finance, however it would be of value to a wider range of stakeholders.

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

Via the questioning at the AGM.

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

Full disclosure of the audit fees (including overruns) should be available to all interested parties. The annual report and disclosures should show full transparency off all balances and judgements where the information is deemed to be of value to any user of those annual reports. The auditors are conducting their audit in order to ensure this is the case in respect of the organisation being audited, hence transparency of fee calculations and charges should be clear for all users of the annual reports.

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

In the majority of cases (as mentioned previously) costs are deemed to be too high and an overhead that is unavoidable. In owner managed businesses the audit is seen as adding little (if any) value and the report is meaningless as the owners/managers are involved in the day to day operations of the organisation. The only benefit in such organisations is where they are seeking to raise additional short term finance.

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

Yes, as mentioned previously, a full breakdown of the fees and any additional costs incurred in completing the audit for the reporting period end. Any additional costs incurred where the audit over ran could be justified in a supporting narrative notes.

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

Yes, most definitely at the higher end of the audit scale whereby large organisations use large auditing firms. Less so towards the lower end of the scale.

Reference:

Mills, S. and Bettner, M. (1992) Ritual and conflict in the audit profession, *Critical Perspectives on Accounting*, 3(2), 185-200.