



## **Bar Council response to Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit**

1. This is the response of the General Council of the Bar of England and Wales (the Bar Council) to Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit.<sup>1</sup>

2. The Bar Council represents over 16,000 barristers in England and Wales. It promotes the Bar's high-quality specialist advocacy and advisory services; fair access to justice for all; the highest standards of ethics, equality and diversity across the profession; and the development of business opportunities for barristers at home and abroad.

3. A strong and independent Bar exists to serve the public and is crucial to the administration of justice. As specialist, independent advocates, barristers enable people to uphold their legal rights and duties, often acting on behalf of the most vulnerable members of society. The Bar makes a vital contribution to the efficient operation of criminal and civil courts. It provides a pool of talented men and women from increasingly diverse backgrounds from which a significant proportion of the judiciary is drawn, on whose independence the Rule of Law and our democratic way of life depend. The Bar Council is the Approved Regulator for the Bar of England and Wales. It discharges its regulatory functions through the independent Bar Standards Board (BSB).

### **Question 1: For whose benefit should audit be conducted? How is it of value to users?**

4. The primary beneficiaries of an audit are the company and the shareholders as a whole. In our view that is appropriate and should remain the case. In practice, there

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[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/794244/brydon-review-call-for-views.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/794244/brydon-review-call-for-views.pdf)

are others who have dealings with or concerning companies that rely on the audited financial statements of those companies, such as individual shareholders or creditors. In broad terms, there is utility in those persons being able to rely on the audit of a company's financial statements. Under the existing law an auditor's general duty of care will not extend to such persons save in exceptional circumstances. We can therefore see that there may be arguments for a statutory extension of an auditor's duty of care generally to persons other than the company. However, there are strong practical countervailing factors against such an extension in liability which would require careful consideration, such as the risk that the liabilities faced by auditors as a profession may become excessive and the fact that creditors, for instance, can if they wish often carry out their own enquiries or take security for their lending.

**Question 3: 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?**

5. From a legal perspective, we do not consider that the law concerning auditors' duty of care and responsibilities requires clarification. It has in broad terms been formulated with sufficient clarity by a combination of the decisions of the courts and accounting standards, and there is the possibility of incremental development or clarification where appropriate. Nor do we consider that any codification of the principles is required to promote understanding of the purpose of the audit since users of audited financial statements will generally be sophisticated individuals or entities and the downsides of codification would in our view outweigh any benefits. We do not offer any view, however, as to whether some other form of statement as to the purpose of an audit or for whom it is conducted may be considered desirable.

**Question 15: Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?**

**Question 16: 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"?**

**Question 17: Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?**

**Question 18: Should such a statement be subject to assurance?**

**Question 19: Who might be capable of giving such assurance?**

6. Questions 15-19: The going concern concept is not well defined. It is therefore subject to considerable interpretation and judgment, and does not necessarily dovetail with any of the company law tests for solvency. Companies' financial statements will be prepared on a going concern basis even where there may be material short-term or long-term risks to a company's continued viability. For these reasons, we consider that it is important to have robust and effective regimes for disclosure of events or conditions that may cast doubt on the entity's ability to continue as a going concern and/or viability statements.

7. We are in principle therefore broadly supportive of proposals to strengthen those regimes and to provide more meaningful information, and robust evaluation of that information, concerning the short- and long-risks facing a company in its financial statements. We agree that at present viability statements in particular are not performing an effective role and that, if possible, these should be reformed to be made more effective and to provide meaningful information concerning a company's viability. However, any proposals would need to avoid the production of boilerplate provisions in a company's financial statements.

8. We also consider that it would be useful for there to be some level of independent assurance regarding such statements. Whether that is feasible in practice is likely to depend on the nature of the information to be provided and/or statements to be made.

**Question 29: 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?**

9. We consider that the auditor's objective in an audit of internal control over financial reporting should be to express an opinion on the effectiveness of the company's internal control over financial reporting. Because a company's internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor should plan and perform the audit to obtain appropriate evidence that is sufficient to provide reasonable assurance about whether material weaknesses exist as at the reporting date. We see no good reason why capital maintenance should be regarded any differently from any other aspect of the company's financial affairs.

10. As regards the second limb of the question, we acknowledge that material weaknesses in internal control over financial reporting may exist even when financial statements are not materially misstated. However, material weaknesses in internal controls may be symptomatic of wider management failings over financial reporting and nevertheless provide a genuine warning to those who might properly rely upon the auditor to identify points of concern. Moreover, what might previously have not been a material weakness so far as the financial statements are concerned may rapidly become one if the regulatory regime were to change. Well-run companies will wish to avoid systemic failures and the regulatory scheme should look to promote compliance and, so far as possible, uphold standards and ensure a consistent application. The regulatory scheme should promote that and support a uniformly rigorous approach by auditors.

**Question 30: 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?**

11. We consider that there is no particular cause for concern on this front: the fact that particular advisers or interest groups might look to complain about, or challenge, a particular legal landscape does not necessarily mean that the landscape is itself unsatisfactory or that such complaint, or challenge, is necessarily well-founded. In terms of the applicable regime, we consider that the legislative standards must be clear and the courts should be left to determine, on a case by case basis, whether or not what has actually gone on actually represents an “improper” distribution within the meaning of the statute and bearing in mind applicable accounting rules.

12. Such issues are clearly tested before the courts from time to time and the application of the statutory rules and accountancy regulations does not appear to cause undue difficulty for the Courts. Moreover, given the width of modern litigation funding techniques, there is no reason to suppose that challenges will not be brought in appropriate cases, thereby helping to develop the underlying caselaw and guide the future interpretation of the statutory restrictions.

**Question 31: Should distributable and non-distributable reserves be required to be disclosed in the audited financial statements?**

13. Yes. We see no reason to reduce this requirement. Moreover, identification of non-distributable reserves may well be helpful in identifying the (legitimate) use that might be made of such reserves, e.g. in respect of a reduction of capital.

**Question 32: 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?**

14. As set out in answer to Q29 above, auditors should be expected to express their opinion on the effectiveness of the company's internal control over financial reporting. This will, inevitably, require an assessment of the company's maintenance of adequate accounting records and that requirement should be maintained and regarded as being an obligation of real substance. As we also note in Q29 above, well-run companies will wish to avoid systemic failures and the regulatory scheme should look to promote compliance and, so far as possible, uphold standards and ensure a consistent application and the regulatory scheme should promote that and support a uniformly rigorous approach by auditors.

**Question 38: Would it be possible to devise a 'reasonable person' test in assessing the auditor's work in relation to fraud detection?**

15. Yes. We consider that it should be possible to provide an objective benchmark standard, a standard that is commonly employed throughout the law. The purpose of this would be to promote and reinforce the significance of the auditor's role and, if this issue is indeed being regarded as more a compliance exercise, help to effect a change in culture so that it comes to be regarded as an important and substantive part of the audit function.

16. However, it is important to appreciate the necessary limitations upon an auditor's role in relation to fraud. An auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error. That is not, however, to suggest that such a

standard cannot be set or that auditors could not plan their audit processes in order to look to assess and identify such risks where they can.

**Question 42: 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?**

17. As set out in answer to Q1 above, we can see that there may be arguments for a statutory extension of an auditor's duty of care generally to persons other than the company. However, there are strong practical countervailing factors against such an extension in liability which would require careful consideration, such as the risk that the liabilities faced by auditors as a profession may become excessive and the fact that creditors, for instance, can if they wish often carry out their own enquiries or take security for their lending.

**Bar Council<sup>2</sup>**

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<sup>2</sup> Prepared for the Bar Council by the Law Reform Committee.