

# **Independent Review into the Quality and Effectiveness of Audit**

## **Call for Views**

## **Duncan & Toplis Limited Response**

**Launch 10 April 2019**

**Respond by 7 June 2019**

## Contents

Chapter 1 – Definitions of audit and its users .....	3
Chapter 2 – The ‘expectation’ gap’ .....	3
Chapter 3 – Audit and wider assurance.....	4
Chapter 4 – The scope and purpose of audit.....	5
Chapter 5 – Audit product and quality .....	8
Chapter 6 – Legal responsibilities .....	9
Chapter 7 – The communication of audit findings .....	10
Chapter 8 - Fraud .....	11
Chapter 9 – Auditor liability .....	12
Chapter 10 – Other issues.....	14

# Views requested

## Chapter 1 – Definitions of audit and its users

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

R1: Fundamentally an audit should be conducted for the investors of a business. However, other stakeholders could be considered. Notably, employees and unsecured external creditors. Auditors cannot be expected to have a responsibility to the 'wider-public'.

Audit provides value by scrutinising financial information and giving an opinion on said information and reporting this opinion on the public record. Assurance of the material accuracy of financial information is given. The user should gain confidence in the financial statements the audit opinion is on (or not in the instance that a modified opinion is issued).

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

R2: If financial reporting standards are enabling reporting to accurately reflect the performance (and perhaps an assessment of the Companies Act requirements relating to the integrity of the directors/management of an entity then confidence in the entity and the financial statements should go hand in hand, financial statements should reflect the position of the entity.

However, financial statements are focussed on the past, not on future performance. Should the audit look at future performance? We believe only to the extent of the going concern assumption. It would be impossible (would place excessive liability onto the auditor, perhaps to such an extent that appropriate insurance could not be obtained) to give an audit opinion on the potential future performance of an entity, to the level required, for example, to assist with investment decisions.

### **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?**

R3: Yes. This would remove subjectivity and help to reduce the 'expectation gap'. The law should clearly state the purpose of audit and for whom it is conducted.

## Chapter 2 – The 'expectation' gap'

### **Q4: Do respondents consider there is an expectation gap?**

R4: Yes.

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

R5: There is a public perception that auditors are there to provide absolute assurance that financial statements are not materially misstated and will absolutely continue as a going concern. That is not the case, with reasonable assurance being provided.

There also seems to be a feeling that auditors are the main party to blame when there are occurrences of significant corporate fraud, even if that fraud has been instigated by senior directors, who in turn have deliberately misled the auditors, putting auditors in a very difficult position. However, an audit file should clearly evidence what procedures have been performed for the auditor to be comfortable that they have performed testing necessary to spot any material fraud that they should reasonably be expected to have spotted.

Company law and financial / auditing standards must be explicit in what is expected of auditors and what accounting treatments of more contentious areas of financial statements are acceptable – perhaps the financial reporting standards should be modified to ensure that there is less choice.

It needs to be made explicitly clear that it is the directors of a company that are responsible for that company, not the auditors and auditors perform reasonable procedures, on a test basis and provide reasonable, not absolute assurance.

**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?**

R6: As shown by the FRC reviews of PIEs, audits are not being consistently performed to a high standard and therefore there must be a gap between the current requirements and the audits being performed at the PIE level. However, quality reviews of SME/OMB marketplace audits, often performed by auditors in the top 40, are consistently performed to a high standard.

As the call for views document notes there are two issues. Firstly, that the public expects too much of audit and secondly, that the requirements of auditors are not always adhered to, creating a double-impact on the trust of the profession.

## **Chapter 3 – Audit and wider assurance**

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

R7: It is difficult to say exactly which elements of business should be covered by audit, it is more important to establish which elements are covered and ensure that this is clearly communicated and set-out in legislation.

Back to the question – we feel that audit, a statutory audit, should cover the contents of the financial statements. This may require enhancement of some elements of the statutory audit process, auditing of going concern for example, or the accompanying reports such as the directors’ and strategic report.

**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?**

R8: No, the level of assurance given by an audit opinion must always be consistent. However, (and we feel that this is key) the level of work required to achieve the required level of assurance and the standard procedures to be performed will likely differ dependent upon the client - for example PIE / non-PIE. Given the complexity of a PIE more work and enhanced procedures are likely to be required. Greater independence would also be a requirement of PIE auditors (e.g. audit performed by a separate legal entity to an entity providing other services).

To summarise, the level of assurance should not differ, but given the differences in size and complexity of entities, the procedures required to achieve reasonable assurance will differ, greatly.

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

R9: Yes.

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

R10: We believe that they should be able to use the work of an internal auditor as an indication of issues that their work notes, but the external auditor must perform procedures to verify the results. We are in agreement with the UK ISA 610. Careful consideration would always be required, by the external auditor, relating to the independence of the internal auditor from the entity, even if the ISA allowed for reliance to be placed on their work.

**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?**

R11: No. Independence is absolutely key in ensuring the audit has been performed to a high standard. Yes, there are arguments that individuals that have a detailed knowledge of a client could design certain tests and assist with the client more, but an independent audit is exactly that, independent.

Additional assurance assignments can be tailored to the needs of the client, but the independent audit must remain.

It should be noted that the ethical standard already has differing requirements for PIEs and other entities, relating to independence.

## **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?**

R12: Perhaps for PIEs / larger more complex entities, but this is not practical for smaller OMEs. Sometimes such an entity may not have detailed risk management and internal controls documented and therefore they will not be able to reasonably make an explicit statement in this area. Similarly, auditors of such an entity would not currently place any reliance on the testing of internal controls, instead taking a wholly substantive approach, which is acceptable under the ISAs. So, maybe, but only for larger, more complex entities.

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

R13: Again, this may be applicable (to extend the requirements) to PIEs / larger more complex entities, but often not for smaller OMEs.

Yes, there is scope to clarify the requirements, although it is felt that the current ISAs are quite clear in this area.

**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?**

R14: No, not in addition to the requirements currently set out in the ISAs, if this was to be reported as a firm opinion. An entity's internal control system may be confidential and any additional reporting of it may not be in the interests of shareholders. If potentially material issues, directly relating to internal controls are identified, then their impact should already be reported through the audit report.

However, if these views were to be communicated as part of the audit report, but in a more descriptive style, for example a traffic-light style table, where the auditor alerted the user to potential issues (separate to the opinion) then the user would have a greater understanding of the entity and its control environment.

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

R15: ISA 570 is currently under review and a consultation is taking place regarding the changes proposed within it. The revisions to ISA 570 provide more stringent requirements for UK auditors compared to the requirements set out for auditors under the International Standards.

The associated company law and accounting standards should support the requirements of the updated ISA. i.e. perhaps specifically requiring directors to formally assess going concern and to document such an assessment and to disclose the conclusions of such an assessment – at least for PIEs.

The fundamental issue when considering going concern is that it is forward looking and sometimes events occur that are simply not possible to anticipate, resulting in the collapse of an entity.

**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”?**

R16: There is already the requirement for such events or conditions to be clearly disclosed in the financial statements and if not, the auditor should modify the audit report, if the disclosure is not adequate.

The issue therefore is not that there needs to be greater transparency, but that directors (in the first instance) and auditors need to ensure that these issues are disclosed.

Auditors, following the revised ISA 570 would have performed reasonable work to ensure that they have done all that can be reasonably expected to try and identify any going concern issues.

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

R17: It is believed (only for entities currently required to prepare a viability statement) that the statement should not be a ‘boiler-plate’ statement but be specifically tailored to the entity making the statement.

Directors already disclose their opinion on going concern and the information disclosed through the viability statement. There’s a limit to how much the directors of an entity can state about the ongoing sustainability of an entity.

**Q18: Should such a statement be subject to assurance?**

R18: If such an additional statement would be deemed to be required, it would be very difficult to be able to provide assurance over such a statement, in addition to the work that is already required on going concern and the viability statement.

Auditors could fact-check certain elements, for example signed contracts, but there’re likely to be too many unknowns for this to be practicable.

Perhaps some form of limited assurance, with those providing the assurance noting if they have evidence that the statement is highly likely to be inaccurate.

**Q19: Who might be capable of giving such assurance?**

R19: Potentially the auditors, but it wouldn’t form part of the statutory audit report (reasonable assurance would be difficult to obtain).

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

R20: Possibly, but fundamentally, how can a third party be expected to test something that hasn't happened yet and provide assurance to the level expected of a statutory audit?

The benefits to the user are clear, they would have a better understanding of the future.

The risks are also clear – providing assurance on events yet to occur, in addition to the work on going concern would be very difficult to achieve. The additional liability placed on an auditor will be significant and undesirable.

However, disclosure by the auditor, in the audit report could be enhanced to give greater clarity over the work that has been performed to support the going concern assertion. For example, that sales contracts have been entered into amounting to £X for the coming year have been verified. Additionally, the risks faced by the entity relating to going concern could be highlighted, as could the entity's mitigation plan for those risks. This could be focussed on PIEs.

**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?**

R21: Yes. It would enable the user to clearly understand the metrics provided.

It is believed that if audit or additional assurance must cover such results then there needs to be clear standards both for the reporting of such metrics and KPIs (statutory rules) and clear assurance / auditing standards covering the testing of such information.

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

R22: All of the 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?**

R23: We believe that the question should be whether the quality of the auditor's performance against standards / quality of audit output in meeting the expectations of users should be considered separately. In this case, yes, they should be considered separately.

**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?**

R24: It could eclipse the focus, but they should be the same thing. A 'completed' audit file would only be considered 'complete' if it was to evidence considered judgement. If not, it is just a box ticking exercise, not what the ISAs require.



ISAs clearly require the auditor to exhibit professional scepticism.

However, the attitude from the FRC (and QAD) does seem to be one to push for a 'completed' file, in the sense that every aspect, of every ISA is adhered to. This focus could push firms to tick all points, rather than really focus on the matters requiring judgement. The reviewers (and standards) need to help auditors to focus on the matters requiring judgement as a priority over areas that are more of an administrative task.

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

R25: It would provide greater understanding of potential issues faced by the entity under review. However, it would be absolutely vital that such graduation followed a strict framework, or the reports would differ from entity to entity and therefore may end up meaningless.

It may be beneficial to keep a binary report, although require (backed by a clear reporting framework) sufficient narrative to explain more precisely which areas of the financial statements pose of higher risk than others.

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

R26: Yes, as noted above.

**Q27: What would prevent such disclosures becoming boiler plated?**

R27: Strict reporting requirements requiring that the narrative was specific to an entity and that such narrative covered certain requirements.

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

R28: Probably not that significantly. Audit, by its nature interacts with a wide-variety of stakeholders and (for example the ICAEW) the leading institutes have for years been actively involved in looking at how audit can be shaped for the future.

## **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?**

R29: The primary role of the auditor (in this area) should be to ensure that matters are complied with that may have a material impact on the entity under review.

It cannot be the auditor's role to ensure compliance by directors of all laws and regulations. The scope of this could be endless.

As per ISA 250.

The question is often not whether a distribution is being made illegally, but more whether it is in the interest of the business?

The question of whether or not a distribution has been illegal stems from whether the rest of the financial statements are materially accurate. For example, if a company with £100m profit and loss reserves makes a dividend of £90m, then it is legal. However, if the reality is that, that company had goodwill assets on the balance sheet of £100m and the reality was that they were worthless, if this reality had been correctly reflected in the financial statements, then the distribution would be illegal.

Therefore, if accounts are accurate, detection of materially illegal dividends can be easily identified.

**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?**

R30: Company law and accounting standards should be aligned, specifically so there is no doubt in this area, if there is in fact any inconsistency. Any perceived inconsistencies between accounting standards and company law could lead to a greater 'expectation gap'.

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

R31: Yes. Currently this isn't the case, but since the entity should have a very clear record of this it wouldn't be overly costly to provide this information and would be beneficial to the users of the financial statements.

**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?**

R32: They perform audit procedures on those records as set out by the UK adopted ISAs. Whether these requirements are effective is covered elsewhere in this report.

## **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?**

R33: Potentially for PIEs. There is certainly scope for shareholders to communicate directly with auditors and therefore make it a requirement for an annual meeting with shareholders.

This could also lead to the decision by shareholders to commission additional assurance activities, to be performed by the auditor in addition to the requirements of a statutory audit.

‘All stakeholders’ would need to be very clearly defined if it ever was to be a consideration and must exclude the ‘wider-public’ that may only have a passing interest in an entity.

It must also be remembered that there is the AGM that should already give stakeholders the opportunity to raise appropriate questions.

**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?**

R34: Perhaps there is scope for this, but standards must exist to set out exactly what needs to be reported and when. It cannot just be left for directors to pick and choose what additional elements are disclosed, if any. Again, confidential information that does not have a material impact on the financial statements should not have to be disclosed.

**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?**

R35: Yes, this would be beneficial. It is often standard practice for auditors to report on issues raised in the previous period in documents generated for directors (such as a key issues memorandum) therefore the users of the financial statements would greatly benefit from an update, in the audit report, on issues raised in the previous period.

## **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?**

R36: No. It appears that the wider-public have the expectation that auditors should detect all fraud. This is not the requirement from either UK law or auditing standards.

Auditors cannot be made responsible for the detection of fraud that does not have a material impact on the financial statements. The potential liability would be too great. However, even the current standards could be construed as placing a responsibility on the auditor for detecting material fraud. If there’s a material fraud, then the financial statements are materially misstated (maybe)? The responsibility is to have performed appropriate procedures to attempt to detect material fraud.

To answer clearly, no, auditors shouldn’t have the responsibility to detect all material fraud, rather they should be able to evidence that they have performed appropriate procedures and

obtained sufficient, appropriate audit evidence relating to potential fraud. The directors of a business will always be in the best place to detect fraud.

Fraud committed by the directors of the entity will be very difficult to detect. Therefore, as long as the auditor can show that they have performed appropriate procedures to detect fraud, they cannot have the responsibility to have detected fraud.

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

R37: Yes, in terms of material fraud. It cannot be the responsibility of the auditor to detect all fraud, that would not be possible.

Auditors are well aware that their procedures need to be able to reasonably detect material fraud.

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

R38: Possibly, but the issue here is that it must focus on material fraud and that such a fraud could be reasonably identified.

Ultimately if senior directors of an audited entity are acting in collusion in a complex business to instigate a fraud, it would be very difficult for an auditor performing appropriate procedures to try and identify such fraud, to actually identify it.

Any definition of a 'reasonable person' must make it clear that a 'reasonable person' would not expect auditors to discover every fraud and take into consideration the behaviours and actions of directors of a company.

Auditors are and should always be watchdogs, not bloodhounds.

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

R39: Only for larger, more complex entities would this be a reasonable request. For the audit of such entities, yes, this would be reasonable. Smaller entities may not have such systems clearly defined and documented and therefore giving a detailed report in the financial statements may prove to be difficult. However, there could be some brief comment such as "the systems to prevent and detect fraud are appropriate for the size of the entity"?

## **Chapter 9 – Auditor liability**

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

R40: Yes. Why would any industry openly accept far increased risk, especially when the rewards for accepting increased risk may not be significant? Change, in the context of this review almost certainly would entail increased risk on the part of the auditor and therefore change must be coupled with a liability cap.

The introduction of shared audits must be considered. This option appears, unfortunately, to have been dismissed by other reviews. Joint audits, placing joint liability on a big four and mid-tier firm may pose too much of a risk for the smaller firm.

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

R41: It would assist in the auditor looking at additional areas of reported material – perhaps extending their opinion over additional areas of the financial statements or become more forward looking and reducing the expectation gap. If the liability to be suffered by the auditor was capped, then there would be more freedom for them to act and push the liability (potentially) to those responsible for a given issue (the directors for example).

As noted in the call for views, this, linked with the reputational damage suffered by audit firms for failed audits, may push up audit quality (despite on the surface of it acting in the opposite direction).

**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?**

R42: No. This would put auditors in an impossibly high-risk position.

Given that the CMA are trying to increase competition in the audit market, why would mid-tier firms want to try and compete with Big Four if they have to expose themselves to such a high risk? Even if total liability of the auditor was capped, the extended scope of responsibility would be unreasonably great.

**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?**

R43: An audit liability cap, freeing up auditors from a financial loss perspective may free up auditors to give an opinion on a wider-range of areas contained within an entity's annual report.

**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?**

R44: No issues have currently been noted, but if auditors are expected to give an opinion on more areas of an annual report and to a wider-scope of stakeholders, without any cap on liability then there will be an ever-increasing risk of not being able to obtain PII cover.

## 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?**

R45: New technology is being used on an increasing basis. From our perspective as a mid-tier firm we have developed the use of data analytics and use this on all audits for testing client journal entries. Technology enables testing on a population, rather than sample basis and therefore significantly increases the level of assurance that can be given. This technology allows our focus to be on those higher risk transactions.

The use of technology is endless and will continue to play a more important role in the audit process. Use of machine learning, AI and blockchain technology will all play a role.

**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?**

R46: New technology can quickly identify issues from large populations of data that simply would not have been identified through traditional testing.

This may even free-up the time of auditors to exhibit a greater element of professional scepticism on the results of using such technology, rather than spending time looking at performing traditional tests.

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

R47: Our initial thoughts are that there are no areas of the audit process that are no longer necessary or desirable.

We do not believe that auditing notes to the financial statements can be dropped, but then start to audit some other elements in more detail.

**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?**

R48: There needs to be financial reporting and auditing standards in place that are proportional to the size and complexity of the entity under review and reasonably act on the current 'expectation gap'.

The auditor must comply with those standards. If compliance with those standards is achieved, then audit will of a high standard.

It is vital that additional requirements on PIEs must be clearly reduced for the requirements on smaller, less complex entities.

**Q49: Does today's audit provide value for money?**

R49: Yes, if anything the issues regarding audit quality, particularly at the PIE end of the market stem from audit being too cheap, being used as a loss-leader to obtain more lucrative work. This is being addressed in separate reviews.

**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?**

R50: If users are demanding a closing of the 'expectation gap' then they must also expect increased costs.

**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?**

R51: It would be expected that any conscientious investor would read the audit report of any entity that they were to invest in, in detail. The information is there, why wouldn't they read it? AI could play some role in scanning reports for standard words identifying qualifications or emphasis of matter and could therefore assist investors in selecting reports that they may potentially want to pay more attention to.

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

R52: Yes, why not? Arrange a suitable meeting. Surely this would be desirable? It would give an opportunity to shareholders (potentially without the presence of directors) to question the narrative of audit reports / to further understand the procedures that have been performed and to potentially discuss additional work that they may want the auditors to perform.

Again, this is focussed on the top end of the market, for PIE audits. Many mid-tier firms audit firms owned and managed by the same individuals.

**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?**

R53: Again, when looking at the PIE end of the market this would appear reasonable. Simply arrange a shareholder meeting in advance of the audit to agree on such matters, away from the influence of directors.

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

R54: The main source would be from internal audit work. The scope of such work would often be set by directors, but what is stopping this from being directed, directly, by the needs of shareholders?

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

R55: There would have to be clear, objective standards that such a report would be based upon. It would not be appropriate to simply have auditors include some sort of subjective commentary. There could be certain reportable factors – perhaps a summary of any supplier payment issues, or report on CO2 emissions (from the auditors). Such values could, potentially be verified. Perhaps some commentary of the bonus system / but this would likely be close to the mark in terms of confidentiality.

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

R56: Audit working papers, especially relating to areas of significant risk must clearly demonstrate the thought process employed by the auditor in addressing the identified risks. For example, if placing some reliance on controls for revenue testing and an error was noted, root cause analysis (RCA) could be employed to clearly identify why the issue occurred. Nothing should be simply recorded as “the client said so”, everything of significance must be verified with supporting evidence.

The file should have enough words to clearly show the sceptical nature of the auditor.

Publicly, the audit report could highlight the key risks that have been identified by the auditor and the work performed to address those risks, giving transparency to the users of the audit report.

**Q57: Should the basis of individual auditors’ remuneration be made available to shareholders?**

R57: At again, the PIE level, this would seem reasonable.

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

R58: From various reports it would be a fair claim that fees are currently insufficient, particularly at the PIE level. This judgement is in comparison to other service lines offered, particularly by the Big Four where far greater levels of profit are noted, often at a lower risk.

Audits shouldn’t be rushed and even at a mid / lower-tier level some firms seem to be taking a ‘race to the bottom’ approach, undercutting rivals. This cannot have a positive impact on audit quality. Partners / shareholders of accountancy firms will expect recoveries to be maintained and with increasingly stringent audit and financial reporting standards the only thing left to give, is quality.

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



R59: Probably. There is already the requirement to clearly split the fee between audit and other services. Any specific split of the audit fee would need to be clearly set out in financial reporting standards.

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

R60: Currently audit still generates a profit, but discussion of the market (especially at the PIE level) indicates that audit is not as profitable as many other areas of service offered by the accountancy profession. With increasing demands of the risk / liability faced by the auditor fees will have to increase to ensure that a high-quality audit industry is maintained.

**Other Comments**

There have been a series of high-profile audit failures in recent times. This coupled with the income earned from these failed entities by the Big Four have put the entire audit profession in a bad light.

However, this ignores several factors. It ignores the fact that auditors should not be and are not primarily responsible for the financial statements of an entity, that is the role of the directors. It is also not and should not be the role of the auditor to give an opinion of the likely success or failure of an entity outside of their requirements relating to going concern (how can an audit opinion cover future events of a business they are not party to running?).

Also, of great importance is to clearly separate the complexity and requirements of auditing a PIE compared to an owner-managed business. There cannot be a 'one-size fits all solution' here. Clearly defined standards, clearly separating PIEs from other entities are required. This would probably be coupled with a significant expansion of the definition of a PIE.

Many mid / smaller-tier audit firms supply vital advice to their clients and can do so with reasonable independence. This is appropriate given that often smaller businesses do not have external shareholders and few external stakeholders.

For any new standards, audit or financial reporting it is not appropriate to simply say that they are scalable. The standards must clearly reflect how they are scalable.

It is also believed that there would be a benefit to reducing the options available in financial reporting standards. Fewer options leads to greater consistency and therefore a greater level of understanding for the users of the financial statements.

Auditors, specifically auditors in the UK perform an excellent, high-quality service in the main. They cannot be blamed for the actions of directors willing to indulge in unethical behaviour, as long as they clearly demonstrate that they have performed appropriate procedures.