

7 June 2019

Dear Sir Donald

I welcome your review of the quality and effectiveness of audit. I am pleased to be able to respond to the Call for Views; drawing on my knowledge and experience.

I have been an audit partner, led a business assurance function as CRO, taken investment decisions, been an audit committee chair and was an Executive Director of the FRC (2012 to 2018). During my time at the FRC I had responsibility for UK corporate governance, stewardship and reporting developments; and latterly for audit and actuarial regulation. I represented the FRC at the International Forum of Independent Audit Regulators (IFIAR) and chaired its Global Audit Quality Working Group which engages with, and seeks to hold to account, the six major audit networks on matters of audit quality. I am now based in the US, whence I provide risk, regulatory and governance consultancy and advice.

The views given here are my own and I have referred only to information that is in the public domain.

I urge you to consider the following overarching matters in carrying out your review:

- The UK is an important global economy and capital market which competes on the basis of high quality global standards. UK and other governments over recent decades have urged international convergence to ensure a sounder and more transparent and accountable financial system. In extensive stakeholder engagement whilst I was at the FRC, investors (to whom the current financial reporting and audit model gives primacy) consistently stressed the importance of comparability in reporting. The history and context that has been presented to date in the review does not give sufficient weight to international accounting and audit developments; for many of which the UK was a key proponent and path-finder. Further whilst the UK has been a member of the EU, our domestic laws have developed in line with EU legislation through legal processes that apply in wider, not just accounting and auditing contexts. EU developments such as the adoption of IFRS as the basis of presentation of true and fair accounts have been regularly, publicly reviewed and consulted upon, including wide UK stakeholder consultation, and found to be both sound and desirable. Moreover, as recently as 2016, the UK introduced reforms to the process and product of statutory audit following EU legislation. Government and the FRC consulted on these changes. The majority of respondents urged that the UK did not dismantle those few requirements which already went beyond those being introduced by the EU but also urged that, in introducing new requirements, the UK should not “gold-plate”, that

is not introduce additional regulation affecting businesses and investors. Of course, much has since changed about the UK's attitude to its economy and industrial strategy (and indeed its EU membership). However, what has not changed is that the UK wishes to compete and be attractive on a global stage. Accordingly, I think it is important that the review has an eye to the international context, and the UK's place in it. Not to do so risks (unwittingly) undermining the UK's competitiveness and its ability to influence.

- Investors have consistently given feedback that the current audit product, whilst narrowly defined, is of value to them. It allows them to be assured that the financial performance and position of the audited entity has been fairly reported by its directors and so gives assurance about the past financial stewardship of the business which can then be used as a starting point for future decisions. Whilst there are undoubtedly many more sound audits carried out in the UK than not, there have been too many high profile perceived failures of auditors not delivering, within that narrow product scope. (Audit enforcement investigations are ongoing in respect of the recent business failures cited. It will be important to ensure that, once independent, evidence-based findings are reached, wider implications/lessons are sought). Investor (and public) trust in the effectiveness and quality of the delivery of the current product has diminished. If trust is to be increased, the review will need to consider all aspects of the “trust equation”. Trust exists where self-interest is minimised and common interest promoted; and where the person in whom trust is vested is credible, accountable/reliable and transparent/accessible. I have set out in my detailed answers where I consider there to be further opportunities in each area of the trust equation for the current audit product. In particular there needs to more independence (from professional interests) in international standard setting, and stronger expectations of auditor accountability/reliability in the standards relating to going concern and fraud. I note that several of the questions set out in the Call for Views would result in increased transparency/accessibility of the audit process and/or auditor. As such they are likely to contribute to increased trust.
- As you have highlighted there is a lack of clarity as to the wider public (interest) purpose of audit and therefore what can validly be expected of auditors. That lack of clarity does not pertain solely to audit, but also to corporate reporting and expectations of directors. It would be preferable to review the public interest aspects of reporting and audit on an integrated basis. In doing so not only the direct users (investors) and their needs should be considered, but also those who are (indirect) beneficiaries of high quality stewardship, reporting and assurance. Also those who are adversely impacted when stewardship, reporting and assurance fails. A rigorous public interest framework should be developed, consulted upon and applied<sup>1</sup>:
  - In my view broader and more rigorous assessment of the public interest would highlight that the current PIE definition is too narrow. The definition adopted in the UK is that in EU legislation. The legislation permits member states to define additional entities as PIEs. The UK has not done so. So, the largest private companies, entities with significant numbers of current and former (pensioned) employees, and entities delivering

---

<sup>1</sup> The FRC adopted such an approach in the development of specific Technical Actuarial Standards, for example .

important public services are not PIEs and are not held to the standards of governance, stewardship, reporting and assurance that is commensurate with their economic and social impact.

- Using such a framework would also help identify those matters beyond the merely financial which significantly affect investment and the public interest and so should be supported by higher levels of reporting, scrutiny and assurance. In several areas reporting has already developed but has not been matched by assurance requirements and so the audit expectation gap is widening.

I have addressed the specific questions set out in the Call for Views in the attached Appendix.

Yours sincerely,

Melanie Hind MA, ACA

## APPENDIX : Call for Views Questions

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

See covering letter as to distinguishing between direct users and wider beneficiaries. There is value to both. In the current product this relates to assurance as to past financial stewardship which provides a valued basis for investment decisions and confirms that public financial obligations are being met. However greater value could be derived for both users and beneficiaries by addressing broader matters and addressing prospects, not just the past and present position of the entity.

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

See covering letter and Q1. Given the growing desire for investors and the public to be satisfied as to the environmental and social impact of entities, reporting and assurance (aka audit) should be wider than 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?

See covering letter. Reporting, directors responsibilities and audit scope should be reviewed on an integrated basis. It would be helpful to have the high level societal purpose of reporting and of an audit expressed in law and to have regular review of how that purpose is met by developing, consulting and regularly reviewing a public interest framework. Not expressing a high level purpose risks a repeat of today's confusion.

Q4: Do respondents consider there is an expectation gap?

There are several expectation gaps in respect of delivery of the current product and the scope of the current product.

To date, attempts have been made to address the expectation gaps by seeking to explain the nature, scope and limitations of the current product and by widening its scope to bring other matters into the purview of the auditor but stopping short of requiring assurance.

Audit and assurance is rarely sought by directors, investors and other stakeholders unless it is mandated by law or regulation. Whilst the audit and assurance profession might suggest other areas on which audit and assurance should be provided, this is seen as self-serving and so distrusted. Law and regulation setting the scope and nature of audit and assurance requirements have not however kept pace with investor and other stakeholder expectations.

The opportunity of this review to more clearly articulate the purpose and scope (expectations) for assurance in today's economy and society is welcome. Ideally a mechanism or body for regular review will also be established.

However even having closed or narrowed specific gaps in expectation, it is unlikely that there will be no remaining gaps or that new ones will not open up. Assurance can never be absolute, particularly in respect of more forward-looking matters.

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

See Q4 and covering letter. The current product is narrowly defined and assurance is not given on a wide range of matters that affect the public interest, yet investors and society increasingly wish to see reporting on and assume assurance about those matters.

I think that there are specific expectation gaps in the delivery of the current product resulting from:

- The mindset of the auditor flowing from the narrow and technical confines of current law, regulation and standards. As was identified in the FRC's review of audit culture, auditors described the technical objective of the audit, not its fundamental purpose. A refocus on purpose and impact might help re-set auditors' approach to their work. This is particularly the case in respect of going concern which has been defined narrowly by accountants and auditors rather than encompassing the concept of viability.<sup>2</sup>
- The requirement is for the directors to present a "true and fair" view and for the presentation of that view to be audited. Most laypeople expect that the "true and fair" view is being presented and audited. Yet given the wide range of possible outcomes when accounting for today's complex transactions, and in valuing assets and liabilities, this is not likely to be achievable.
- The auditor assesses whether the view presented by the directors is a true and fair view. The audit process is focused on whether what the directors have presented can be justified. Some expect that the focus should be on whether the auditor would have presented the same view if he had prepared the financial statements himself. This expectation could be met by resetting the objective of and standards for audit.<sup>3</sup>
- The auditor's mindset about the detection of financial fraud. The expectation is that the auditor will root fraud out. Yet, as has been set out in the Call for Views, audit standards carry forward the (somewhat dated) legal premise that the auditor is a watchdog not a bloodhound. In my experience auditors sometimes use this to minimize their work effort on financial fraud detection and to justify a lack of scepticism around fraud identification. When the watchdog role was described it may have been an unrealistic expectation for the auditor to be able to cover sufficient transactions in his work so as to be able to root out fraud. However, with the use of technology and more developed forensic techniques, I consider that audit standards could and should be developed to better meet expectations; holding the auditor to a higher level of accountability. (The audit firms all have forensic accounting ability, for example, yet that ability is rarely used on audits. Audits are carried out based on samples rather than full forensic investigation).
- The fact that the auditor can reach his view either by testing substantively or by testing controls. Many expect that there is a focus and therefore assurance on the operation of controls which it is assumed will operate in the future. ( See Q12).

---

<sup>2</sup> The Sharman review and subsequent FRC publications explored this matter in some detail and may provide helpful evidence for the review.

<sup>3</sup> Interestingly, the US Common Sense Principles 2.0 set out that the Audit Committee should ask the question would the financial statements be different if the auditor had prepared the financial statements himself.

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?

You have specifically asked if there is an audit quality gap in respect of the current product. Audit quality is not defined.

The FRC has for over a decade carried out audit quality inspections focused on delivery in accordance with law and standards and has reported publicly in aggregate and on each of the major audit firms. It reviews around 170 PIE audits on a risk selection basis annually. A handful each year are below the required standard and taken to enforcement action. ( The FRC also oversees the professional bodies' reviews of non-PIE audits which have similarly low referral to enforcement rates). When measured against expectations of quality above the minimum levels required by law and standards however, progress has been made but is stalling, despite significant effort and investment by most firms. <sup>4</sup>

Compliance with law and standards is unlikely, however, to be an entirely satisfactory measure of quality if the expectation gap is to be narrowed. As the review develops its purpose, objectives and scope of audit and assurance it may wish to consider how quality (or success) should be measured.<sup>5</sup>

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

See covering letter and earlier responses. Also Q8.

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?

I believe that it can but should be varied based on the risk/impact to the public interest. (See earlier comments on the desirability of a decision-making framework).

Application of such a framework is likely to identify that there are strong public interest reasons for there to be reporting and assurance on:

- Fraud
- Viability/going concern
- Risk management
- Internal controls
- Some ESG matters

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

In respect of the current audit product, the boundaries are clear in that internal auditors do not have the annual financial statements in their scope and focus on other areas of the audited entity. In financial services, where there is a requirement to have an internal audit function, the function is described as

---

<sup>4</sup> I have addressed laws about capital maintenance and the auditor's role in later responses. I consider that the law is clear and that auditors are discharging responsibilities as they stand.

<sup>5</sup> Auditors and regulators in several countries , and IFIAR, are developing audit quality indicators and broader measures of audit quality ( for the current product) beyond external inspections focused on law and standards compliance. The FRC has sought to develop an agreed description of audit quality addressing wider expectations, which may be of assistance to the review. See FRC developments in audit reports.

the third line of defence and has a role in ensuring that business assurance functions are operating effectively.

Most internal auditors are employees of the audited entity and so their livelihood depends on the success of the entity and their interests are therefore seen as conflicting with the interests of those outside of the entity. Accordingly, it is unlikely that the public would trust a public product produced by internal auditors.

In a large number of cases internal audit services are provided privately by those same firms that also provide statutory audit services (to other entities). If the scope of independent, public assurance expands then the functions of these external providers of internal audit will be encompassed in the new audit product.

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

To the extent currently set out in FRC standards which were only recently consulted upon.

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 focus on independence (ensuring no conflicts of interest arise) is fundamental to public trust and should not be diminished. However the focus on reducing the level of non-audit services, by which is meant the provision of any service other than statutory audit has limited the auditors ability to carry out independent assurance beyond the financial statements unless they are required by national law or regulation. As noted earlier, assurance that is not mandated is rarely commissioned and so it is the lack of mandation rather than the focus on independence that has limited innovation around the scope of the audit product.

So far as innovation within the confines of the current product is concerned, there have of late been innovations principally based around technology. Such innovation in my experience has been prompted by a desire for greater efficiency and effectiveness of the audit product. The introduction of retendering has also prompted some competition around innovation in the current product.

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 - for financial risks and controls.

It is a matter of regret that, in implementing improvements to company governance and stewardship post financial crisis, the UK considered the reporting by directors on controls and assurance on that reporting to be an unwarranted regulatory burden. There is considerable power in requiring statements of effectiveness (even in boilerplate terms) because boards ensure they can support such statements and practice is improved. The US introduction of such a requirement in respect of financial controls has improved the quality of financial reporting and has ensured that auditors address controls (not doing only substantive testing) as is expected by many. It appears that in some recent, high profile UK business failures that controls had broken down. The UK should introduce a similar approach for financial controls for entities that affect the public interest.

I think it likely that for those entities it will also be desirable to move to director statements about the effectiveness of other ( non-financial) risk management and controls, rather than the current requirement to simply say that an assessment has been made and explain what action has been taken. If this is done, then assurance could be provided.

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

See Q12 – yes if directors are required to 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, if as part of a broader controls reporting and assurance regime. Currently the auditors work on controls may be too limited to present the full picture. That said, the auditor is obliged to consider the impact of the control environment on audit risk and there may be merit in making this assessment more accessible.

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

This matter was extensively considered in the Sharman review whose reports will be of assistance to the review. In short, the term going concern has become an accounting technical term and statements that the going concern basis of accounting has been adopted are of limited value. Without changing law the FRC sought to move directors to a more meaningful assessment of viability through the introduction of the viability statement for those entities adopting the Corporate Governance code. Research by EY following its introduction showed that the requirement had prompted better consideration by directors of the entity's longer term<sup>6</sup> viability and had improved risk management. However, it appears that that initial improvement has receded and that directors are setting very cautious viability timeframes, despite the "safeharbour" developed for such reporting.

I think there is a case for giving the viability statement more force by making it a legal requirement and for it to be assured as setting out the reality of the entity's risk management and its processes. User engagement and challenge on the viability statement should also be encouraged so as to promote improvement and trust. For example, the viability statement might be separately approved at the AGM.

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. The statement that the going concern basis of accounting has been adopted is of limited value but disclosure of significant doubt is of more value and relates to viability.

Further, I think that the auditor's responsibilities in ensuring such disclosure is made could be improved in the standards and be reemphasized in practice. The standards current requirement to "remain alert" is

---

<sup>6</sup> That is longer than the going concern basis of accounting



too weak and there should be more proactivity (as suggested by the FRC in its recent consultation). The auditor could also be more transparent about how the proactive assessment was made.

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

See earlier

Q18: Should such a statement be subject to assurance?

See earlier

Q19: Who might be capable of giving such assurance?

See earlier

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

I consider that several of the more forward-looking statements by directors in areas that affect the public interest could be assured by assuring the comprehensiveness and effectiveness of the underlying processes. This would close part of the expectation gap.

The risks are that no process can capture every risk and so the level of assurance given is unlikely to meet the expectations of some.

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?

Potentially yes. Such matters should be considered under the public interest framework (see cover letter) which would balance risk and impact in the public interest against cost. It seems that where that balance lies can change over time. For example the disclosure and assurance of payment practice disclosures was dropped from company law during my time at the FRC, with a deregulatory focus. It has now been reintroduced as a reporting requirement (through different regulation), without assurance.

As well as considering the matters listed in the question under the framework, consideration should also be given to whether reporting to public interest regulators should be assured. For example, the banks' risk weighted asset submissions are not assured. Compliance with client asset regulation is.

The Call for Views explains that preliminary announcements are not audited. This is correct however there is a level of assurance as to their reliability in that the auditor needs to have completed his audit in all material respects before they are issued. The FRC recently consulted on whether a formal audit requirement should be introduced. It was concluded that the current approach provides a satisfactory basis.

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

See Q21

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 , I think this provides a helpful way of framing the review and indeed I have used this approach in framing my responses.

The process that is used for delivery is important and is codified in standards , guidance and promoted best practice.

The international standards are of a high quality, however in some parts they belie that they are developed by boards that are administered and given resource by the profession. There is also a perception of self-interest which undermines trust. The Monitoring Group which oversees the boards had set out proposals to increase independence and the quantum and quality of resourcing of the boards. These efforts appear to be stalling. It will be important for the UK to continue to promote change and the review may wish to consider doing so.

Further, the effectiveness of the process is not just about how individual audit engagements are carried out. The standards also address how the firm should establish and assess its culture of quality. Significant new standards are being issued by the IAASB in this regard and consideration of them in closing some of the quality expectation gap is of relevance to the review.

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?

No. The review may benefit from direct engagement with the FRC to understand its processes which were revamped, following an external review, in 2016. The FRC inspection is not just on individual audit engagements. Whole firm procedures are reviewed. The inspection focusses on key audit matters which tend to be the more judgemental and on other thematic areas of risk. Areas of good practice are reported as well as areas for improvement. The inspectors engage with the auditor and opportunity is given for audit contemporaneous evidence that is not on the audit file. FRC assessments are overseen by an independent and senior committee focused on ensuring proportionality of approach and findings. The FRC's reports which are sent to the audit committee rank the findings and set out their import. Matters of documentation, as opposed to the exercise of judgement, rarely are reported. As the FRC has set out in its annual reports, the most significant area of findings is that the auditor has applied insufficient skeptical consideration in his exercise of judgement.

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

I remain to be convinced that there are overwhelming benefits of such a switch. The directors provide a binary statement that the financial statements are true and fair and it is that statement that is being assured. Accordingly, a binary opinion by the auditor provides aligned clarity.

For a number of years after introducing the extended auditor report the FRC reviewed its implementation, consulting with investors and the audit firms. We were pleased to see innovation in reporting, including the innovation of graduated findings, under a standard which is deliberately non-

prescriptive. However, investors told us that they thought graduated findings muddled the waters and there was concern as to the subjectivity of terms such as “optimistic” and “pessimistic”.

This is a key area where integration between entity reporting and audit should be maintained. It is the case that the range of possible outcomes in measuring transactions, assets and liabilities is wide and the extent of the range of outcomes, key assumptions and their sensitivity may be valuable information. Company law and accounting standards require such disclosure to some extent but tends to be given in narrative terms with limited quantification. Greater quantification could be required of and presented by the audited entity and , so long as the disclosures are within the scope of audit, the auditor can encompass this in his opinion.

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

See Q25. There are some areas of reporting which the auditor makes to the audit committee which it may be informative to disclose publicly either in the audit committee or auditors report. The FRC introduced extended audit committee reporting alongside the extended auditor report and has carried out an initial Audit & Assurance Lab project to explore with investors, audited entities, and investors where greater insight could be provided. Its work may be of assistance to the review.

If further changes are to be made to auditor reporting to provide greater insight it may also be necessary to review auditor confidentiality restrictions.

Q27. What would prevent such disclosures becoming boiler plated?

The requirements for disclosure should not be prescriptive. The need for caveats should be minimized. Engagement by users with the auditor and/or the audited entity in response to innovative and important insights would “reward” the auditor/audited entity.

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

See earlier comments on the need for more independent international standard setting and for there to be investment and resource beyond the profession.

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?

Within the current audit product, it is entirely appropriate to distinguish between matters that may materially affect the financial statements and other matters. The current standards, which have recently been updated, are written on that basis.

If assurance is to extend to other areas of the annual report and accounts, then consideration of relevant laws and regulations is likely to be needed in respect of those areas eg. compliance with health and safety requirements. Where assurance of compliance with laws and regulations affecting other matters is desired it can be developed. A recent example is that the FRC developed a standard for client money audits as required by FCA rules.

Capital maintenance – see next 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 perception of inconsistency described is by no means held by all and so is not widely affecting public expectations. The FRC has considered the challenge of inconsistency carefully over a significant period of time, seeking and publishing independent legal advice and engaging with a wide range of stakeholders to ensure its understanding. The FRC has also reviewed its guidance on true and fair override and its auditor guidance in response to the persistent challenge. Government also considered the matter and issued a ministerial statement.

UK law provides for a stronger capital maintenance regime than elsewhere, in that it references realised profits as a basis for distribution, rather than profits made which is the EU wording. There is no requirement to disclose realised profits, which are determined by analysing retained profits (ie accumulated profits made) which are disclosed. Further, there is no requirement on the auditor to assure the computation of distributable profits. If they were (voluntarily) disclosed in the notes to the financial statements the auditor would (under standards) include them in the scope of their audit. However, in certain circumstances where the quantum of the underlying profits made may be in question either through lapse of time or significant events, there are specific requirements of the statutory auditor to furnish a specific, separate report.

In view of this more prudent (distributable profits) approach in UK law, guidance on the interpretation of the law has been developed, through public consultation, by the ICAEW and ICAS, and from time to time given credence by application in legal cases. The matters to be considered in determining what is realised are necessarily complex. The guidance is helpful in ensuring consistency of approach.

The FRC, partly in response to the challenge of those that perceive inconsistency, carried out a Financial Reporting Lab project on distribution policy and practice consulting widely with investors and companies. Its report and appendices setting out the legal position may be of assistance to your review.

The FRC also followed up with companies and their auditors in a very small number of cases where illegal dividends had been paid and recorded in the financial statements. In most of those cases the dividend had been paid after a lapse of time which meant reference to the accumulated profits in the last annual accounts was not appropriate and so the company had to rectify the position through formal shareholder resolution. The auditors should have considered compliance with this aspect of laws and regulations as it affects the financial statements. The FRC took steps to ensure that auditors were reminded of these obligations. Nonetheless it may be appropriate to do further promotion with directors and auditors.

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

See Q30. The majority of those involved in the Lab project did not wish there to be mandatory disclosure of distributable profits and recommended that there be disclosure only where the quantum of such profits represented a material constraint on distribution.

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 auditor under standards considers the entity's control environment and whether there are appropriate processes and controls to enable the financial statements to be drawn up in an appropriate timeframe. I am not aware of anything that would suggest that the bar for companies and their auditors is not at a high enough level. (It may be that there is some conflation with the ability to determine distributable profits – see Q30 and 31).

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?

See covering letter – increasing accessibility and transparency of the auditor may engender improved trust. That said extended audit committee and auditor reporting was designed to give users of reports a basis for engagement which, so far as I know, few users have taken up.

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?

See earlier response

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?

Only to the extent that those matters remain key to the current financial statements. Being more prescriptive about the content of the report risks stifling insight and innovation.

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

See earlier responses. I believe that there is an expectation gap here that could be closed by requiring the auditor to do more, particularly given forensic technology.

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

See earlier responses. There is opportunity to improve the detection mindset.

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

It is unclear to me what is in mind and so I have not commented.

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

See earlier comments on internal controls. Yes.

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

In my experience, to a limited extent. Where change implies additional litigation risk the profession (like any soundly governed entity) will seek to minimize exposure by ensuring that reliance on the product is granted explicitly rather than being widely inferred.

That said, the UK profession and firms have been among the most innovative globally, most notably in the introduction of extended auditor reporting and in supporting the FRC's public reporting on audit quality.

I note that most of the firms operate as LLPs which may be instrumental in ensuring that their risks are within appetite.

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

See Q40.

It may be helpful to review how such matters are addressed in the US where for example the auditor attests to the operation of financial controls.

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?

Although I am not a lawyer, I think this would be difficult without a clearer articulation of reasonable reliance. See also covering letter comments about direct users and societal purpose/wider beneficiaries.

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?

No response provided.

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 review may benefit from private discussions with the firms, their professional bodies and insurers.

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 FRC issued a thematic review on the use of technology which may assist the review. Its use is not yet widespread but increasing. It has significant potential to improve audit and assurance quality, particularly in identifying fraud and focusing work to areas of risk. In addition, access to "big data" enables the auditor to be more comprehensive in obtaining external sources of corroboration.

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?

See earlier responses – data analytic, forensic and block chain technologies can be applied to many other matters. For example in tracing food products through a supply chain.

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

Nothing springs to mind. The audit of the notes to the financial statements is essential as they are part of the true and fair view presentation.

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?

See earlier comments on the need for a public interest framework and the need to move to assurance over controls.

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

No response given.

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?

See earlier comments on the need for a consulted upon public interest framework. If the beneficiaries of audit are much broader than users, it will likely be the case that the beneficiaries will need to support additional 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?

See earlier comment on the disappointing take up of engagement with audit committees and auditors on their extended reports.

The review may wish to consider whether the UK's implementation of ESEF is likely to have an impact on the use of AI.

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

See earlier responses – particularly on confidentiality. There may be a role for the Investor Forum in arranging meetings and commissioning special reports.

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 committee should be responsive to shareholders. The auditor should be open to input from any source including shareholders.

Scope and materiality are reported in the extended auditor report. There has been little reaction by shareholders to what has been reported, suggesting that there are not concerns in this regard.

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

In my experience shareholders and directors obtain little additional assurance unless it is mandated by a regulator. That said, assurance on ESG matters is on the increase.

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

Auditors providing the current product assess the control environment and management incentives for financial bias in planning their work. That assessment may provide insight to the company's risk and financial culture. However, the auditor does not look at all aspects of how the entity carries out its business and so would not be able to give a full and balanced view.

See the FRC's report on corporate culture and the role of the board which addressed how assurance on culture is and might be provided.

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

Through his extended auditor report, through reporting to the audit committee and through documentation on his audit file which is available for regulatory inspection.

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

Audit fees are already disclosed. The name of the signing partner is disclosed. Disclosing his/her share of partnership profits which may depend on many factors other than his/her leadership of the audit engagement would not provide useful information.

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

With the introduction of retendering and rotation there was concern that there would be downward pressure on fees. As the FRC has reported in its annual reports on developments in audit fees have generally held up, yet the firms have made increased investment in systems to support quality and in technology. Increasing use of technology is likely to mean that the current, longstanding model of computing fees based on manhours spent and scale rates by level of seniority, becomes increasingly irrelevant.

The audit firms do not disclose the profitability of their audit practices and so it is difficult to assess whether the fees charged are justifiable and at a level that ensures an ability to attract and retain high quality resource and provides an appropriate reward for risk. Trust in the profession may be increased by more meaningful transparency.



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

See Q58.

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

See Q58.