

Martyn Jones submission – via email

Thank you for the opportunity to provide views to the Brydon Review .

My background is that I trained and qualified as a chartered accountant with a firm that has since become part of Grant Thornton . I then taught auditing and financial reporting , became an Under Secretary then the Secretary to the Auditing Practices Committee of the Consultative Committee of Accountancy Bodies which was responsible for developing auditing standards and guidelines , became the U.K. and Irish technical advisor to the International Auditing Practices Committee , joined a Big 8 firm , Touche Ross & Co which became a Big 4 firm , Deloitte LLP, was national audit technical partner and had other roles in that firm nationally and internationally for about a quarter of century and finally became the President and Chair of the Board of the ICAEW . Since then I have been Chair of the Advisory Board to the Department of Economics and Finance at the University of Brunel London and provided talks to students at various universities on auditing and employability skills on a pro bono basis .

My personal thoughts are as follows :

(a) As an auditing profession we need to get back to where we came from . One of my mentors was Lord Benson who taught me the importance of professionalism and detailed industry guidance to assist the application of scepticism particularly when auditing in high risk sectors .I became involved with Lord Benson in his capacity as an advisor to the Bank of England following the need for the auditing profession to respond to growing expectations of auditors by the public and the Bank and an earlier fraud in the savings sector. Lord Benson had many public roles including being the first chair of the International Accounting Standards Committee . His prompting helped lead to a series of detailed industry auditing guidelines which over time were superseded by the current series of industry Practice Notes issued by the FRC. However this series should be expanded to cover more high risk sectors and sub sectors thereby giving assistance not only to individual auditors but also to challenger firms taking on audits in sectors that are new to them .It is important that such guidance is kept under constant review and not just updated very occasionally as the “risk universe “ for auditors keeps changing .

(b) Unfortunately we seem to be in an era where it is assumed by some ,on the basis of inspection scores and in relative terms a very small number of audit failures which have high impact, that the general standard of auditing is poor and that massive structural changes are the answer . It is right that responses are made to address the issues that have arisen and to regain trust in audit. However the fixes that need to be made need to be measured responses as misconceived or excessive regulatory responses can have unintended consequences including making audit failure more likely in the future and reducing or even eliminating the number of firms willing and able to audit large U.K. companies . Without auditors verifying and reporting on financial statements it would be significantly more difficult for companies to obtain equity or debt capital and therefore for those companies and UK capital markets to survive and thrive .It is therefore in companies’ best interest to be able to appoint auditors to provide insight on how well or not they have been managed.This is evidenced by a report that 82% of companies listed on the New York Stock Exchange were being audited even before being required to do so by the USA’s Securities and Exchange Acts of 1933 and 1934. (See Wikipedia on ‘Accounting and the late 2000s financial crisis ‘and its underlying references and in particular no.3)

(c) Part of the problem in the UK is that , unlike the USA , there had been a lack of a tough UK corporate regulator . Looking forward the new regulator should be called the 'Governance , Reporting and Audit Authority' rather than the 'Audit , Reporting and Governance Authority ' . It needs to be borne in mind that auditing is a sub set of governance and that putting "audit "before "governance " in its title as recommended by the Kingman Report is rather like putting "the cart before the horse" and setting the new Authority off on the wrong track.

(d) Another problem which currently exists is that the enforcement of section 501 of the Companies Act 2006 ,which is meant to deal with providing knowingly or recklessly a statement(oral or written) that conveys or purports to convey any information or explanations that the auditor requires or is entitled to require and that is "misleading , false or deceptive information in a material particular", seems to be virtually non existent . Until this glaring gap in enforcement is dealt with by criminal prosecutors and the BEIS , the "traffic lights" for deceiving auditors or withholding relevant information from them seem to have been left on the colour "green". There are counter arguments that directors are already subject to too many possible offences or that fraud charges are better to take forward as they carry a much greater penalty. However this misses the key point completely that knowingly or recklessly providing misleading , false or deceptive information or explanations to auditors causes financial reporting failure which can have a devastating and massive impact on shareholders , employees , suppliers and in some cases the wider public.

(e) Similarly there seems to be a lack of disqualifications of directors specifically for providing to auditors information or explanations which is misleading ,false or deceptive in a material particular . I would therefore recommend that this be rectified by BEIS issuing appropriate guidance to criminal prosecutors on the importance of responding to such behaviour by directors by way of disqualification orders and thereby reinforcing the point that it is in the public interest to disqualify directors who have specifically provided false , misleading or deceptive information or explanations to auditors . The ability to do so already exists under the Company Directors Disqualification Act 1986 if charges are successfully brought under section 501 but such disqualification orders are not being made for this reason which again gives out the wrong message to directors who might therefore think lightly of deceiving auditors. If the penalties under section 501 need toughening up to encourage and help prosecutors enforce the laws in this area , then they should be toughened up . I would suggest that this is an imperative if the need to rebuild trust in audit is to be, and seen to be, taken seriously enough .

(f) It also seems incongruous that actions to disqualify directors who deceive or withhold information from auditors should continue to be vested in the Insolvency Service in circumstances when no insolvency has arisen. If this power were to reside in the new regulator in cases of non insolvency it is more likely that improvement would be achieved in this key area and that the new regulator would be seen to have "more teeth " to deal with directors of public interest entities and their subsidiaries than the FRC .

(g) Compliance with auditing standards cannot be expected to work if the evidence obtained by auditors has an unacceptable risk of being misleading ,false or deceptive in a material particular . This problem is exacerbated by a remarkable lack of powers available to auditors when they try to obtain evidence from sources outside a company and its subsidiaries as clearly comes to light from any study of section 499 of the Companies Act 2006 which is meant to set out "the auditor's general right to information " . It also seems astonishing that sub-section 3 of section 499 and sub-section 4 of section 500 actually seem to be designed to prevent statements that are made to auditors to be

used in evidence in proceedings for other criminal charges than under section 501 . These sub sections which appear to be “ Get out of jail free cards “ for other offences should be thoroughly examined by BEIS as they appear to be distinctly suboptimal when compared with the potentially serious impacts of deceptive statements being made to auditors .

(h) There is a need for some proper “root cause analysis “ of recent audit failures to ensure that any proposed changes to the audit process and product are actually relevant to reducing the possibility of such failures recurring . Press reports seem to suggest that the causes include collusive fraud (Patisserie Valerie) , lack of scepticism , acceptance of “group think “ based on best possible outcomes , broken business models and over optimistic going concern assumptions (Carillion , BHS) and sub optimal accounting standards resulting in imprudent dividends or excessive bonuses or both and inadequate share capital and reserves (Carillion and various banks in the run up to the financial meltdown) .

(i) There is also a need to examine various past examples of how major accounting scandals were actually uncovered and to ask whether anything is clearly missing from current auditing that should be included . One thing that immediately springs to mind is that audit firms should be encouraged to offer financial rewards to whistleblowers who bring to their attention collusive fraud or inappropriate accounting treatments or judgements. Clear evidence for this is the massive financial scandal at the Bank of Credit and Commerce (BCCI) which when it was uncovered was described as “the largest fraud in world financial history “. This was not found by normal auditing techniques or by the application of auditing standards but by the emergence of a whistleblower who directed an audit partner to uncover false loans, fraudulent accounts , dubious transactions with offshore companies and active rather than dormant companies incurring substantial losses and expenses which had not been properly accounted for.(See ‘Deep Throat ‘ started rout of BCCI : The unraveling of the fraud at the Bank of Credit and Commerce International owed much to a mystery informant among its staff, Chris Blackhurst , The Independent , 25 October 1992).

(j) Another massive fraud was at Parmalat which resulted in a \$14.3 billion black hole . This included fake sales and cash balances , the use of unaudited off shore companies to hide illegal transactions and an estimated 300 officers and employees colluding in the fraud . The fraud began to emerge when several analysts became concerned about inefficient balance sheet management based apparently on large cash balances whilst at the same time there was burdensome debt which eventually the group could not service. This seems to suggest that generally more attention could usefully be paid by auditors to responding directly to significant concerns of analysts and again points to the need to encourage employee whistleblowers to approach auditors . (See Parmalat - Financial scandals, Scoundrels & Crises , Ron Rimkus , econcrises 29 November 2016).

(k) There is a further need to ensure that there is less rather than more box ticking directed at low risk areas and that more imaginative and early audit work is focused directly towards the higher risk areas. With the advent of more detailed auditing standards too much time is directed towards filling in longer and longer audit checklists and perhaps not enough time is spent on searching for ,and considering , relevant sources of contradictory evidence which are not provided by management but by analysts , trade sector bodies , economists or other third party sources . Some good “ principles based “ work was done by standard setters in developing the new 2018 ISA 540 on ‘Auditing accounting estimates and related disclosures’. In particular more emphasis is now placed in this standard on obtaining both corroborating and contradictory audit evidence on accounting estimates and on the alignment of accounting estimate audit procedures with the risk assessment .

This means that accounting estimate procedures should be more risk based and scalable ,that auditors should have more discretion in determining the level of audit testing and that there should be less “one size fits all “testing . Accounting estimates have globally accounted for a sizable proportion of the negative scores that audit firms have been receiving from audit inspectors , and it is therefore to be hoped that with proper supervision within the firms an effective implementation of this standard will help reduce the audit firms’ negative inspection scores which give the impression that audit is broken even when there may be no evidence that there have been material misstatements . I would recommend that the new regulator should carry out a review to identify where further principled based changes can be made to other auditing standards and to how existing standards should be interpreted from a more principled based perspective . It might also be useful if when presenting their scores the regulator could indicate the number of “shall “ requirements with which it has a problem with particular firms against the total number of “shall “ requirements contained in auditing standards and whether any misstatements have had to be corrected . This would help put the scores in some wider context .

(l) Besides applying some “rear view mirror analysis “ of past performance and past audit failures there needs to be a clear focus on preparing for the next financial meltdown and the end of the extended bull markets . Such events are inevitable given that the level of debt is currently greater than before the previous financial meltdown. The speech that the chair of the International Accounting Standards Board , made in December 2018 should therefore be mandatory reading for your Review Groups particularly those parts about the need to cope with the new expected loss model for financial instruments , the new accounting standard on insurance business and accounting for goodwill . (See Speech : Are we ready for the next crisis? Hans Hoogervorst , IASB, 11 December 2018).

(m) It also seems that some entities fail when economic conditions , currency rates , consumer trends , tariffs , trading arrangements , contractual arrangements, market conditions , supply chains or business models worsen .Examples of these may be some retail store groups not responding sufficiently to the challenge of the disruptive business models of internet companies , some construction companies which have long been in a high risk sector, some infrastructure companies which are required to meet tough contractual conditions with government and which carry a high level of political risk , some businesses that may be particularly impacted upon by Brexit uncertainties and possibly going forward some universities particularly if the level of fees is reduced . There is therefore scope for industry sector specialists and some economists to develop and keep under review a new breed of industry Practice Note guidance for auditors which focuses more on such risk sectors and sub sectors and in particular on the application of audit scepticism in relation to significant risks. This could usefully include suggested procedures around key areas of judgement , industry fraud risks and useful sources of evidence independent of management . I would suggest that practice note guidance would be more helpful than an avalanche of yet more auditing standards . Such Practice Notes could also be helpful to audit committee chairs and challenger firms in particular .The development of these practice notes could be allocated to the ICAEW to develop and then be franked by the new regulator .

(n) Given the warnings made by Hans Hoogervorst , I would also strongly support the current work by the FRC (or a successor body) to revise Practice Note 19 on ‘The audit of banks and building societies in the United Kingdom ‘ and to keep that revised Practice Note under constant ongoing review rather than being updated occasionally. It needs to be constantly borne in mind that banking is a “risk ecosystem “ which keeps changing and that its risks can crystallize very rapidly and with

huge impact on the wider economy.

(o) The FRC is currently updating its auditing standard on going concern but it is important not to view ISA570 in isolation of the wider suite of auditing standards. One of these standards is ISA 580 on 'Written representations'. This standard is far too weak on going concern and on producing generally the right psychological impact on directors.

(p) There needs to be the inclusion in written representations that the directors are expected to make along the lines of "we have to the best of our knowledge and belief supplied the auditor with all the available information and explanation needed for a full assessment of the going concern basis including all relevant risks, events and conditions that relate to the specified foreseeable future and that an unbiased and prudent approach and not an over optimistic approach has been adopted in assessing the impact of those risks, events and conditions on the going concern basis".

(q) Where the audited entity is a UK company there also needs to be an expectation that the directors state that "we have to the best of our knowledge and belief complied fully with section 501 of the Companies Act 2006 in that we have not knowingly or recklessly provided information or explanation to the auditor which is misleading, false or deceptive in a material particular and that we are aware of the legal consequences of breaching this section."

(r) Such written representations would make directors think more deeply about the assessment of the going concern basis and more generally about the balance and content of the audited financial statements. They would also improve the quality and realism of the information and explanations provided to the auditors and make it easier for a more challenging and sceptical approach to be applied not only by auditors but also by non executive directors. It is essential for auditors to be challenging and sceptical but there is a danger of a moral hazard arising if that need is applied just to the auditors and not to the directors including the audit committee who should be expected to review the written representations before they are issued. It would also seem wrong if the fines applied to directors are less than those applied to auditors who make innocent mistakes.

(s) There is also a need to create a more explicit written representation from the directors along the lines that "to the best of our knowledge and belief all bribes and other facilitation payments made by or on behalf of the company or group have been disclosed". It may also be useful to expect directors to make a written representation that to the best of our "knowledge and belief we have not made or propose to make dividends out of unrealized profits and non distributable reserves." This would help elevate the importance of these issues in the minds of directors.

(t) An inherent problem related to the going concern assessment is that business and going concern risks can arise with huge velocity exacerbated by the actions of banks, creditors, suppliers and credit insurers who can suddenly withdraw their support despite earlier statements of assurance and by market movements spooked by profit expectations not being met, investors going short in the market so as to "make a killing" at the expense of other investors, profit warnings and even by fake news in social media. It therefore needs to be made clear that an unmodified or unqualified opinion is not a guarantee of future viability and that shareholders need to take account of half yearly and quarterly reports, information put on investor websites and market announcements including profit warnings.

(u) Another problem is that going concern judgments are not infrequently very difficult to make and

assess . One of the difficulties is that the current binary model for assessing going concern uncertainty is not a good solution as the level of going concern uncertainty is not static and can be at a number of different levels along a spectrum besides material and immaterial uncertainty . It is important therefore that the FRC works speedily on developing a more graduated form of reporting .

(v) More emphasis should be given in ISA 570 on assessing the challenges relating to the business model from disruptive technologies and distribution channels and on contract risks , political risks , global economic risks , tariff wars , Brexit uncertainties , the prudence of dividends and of bonus policies and the impact of new accounting standards.

w) During my time with the Auditing Practices Committee we kept under review the development of new accounting standards and company law from the perspective of their potential impact on auditors . It is imperative that such work as this is continued by the new regulator or by the ICAEW and that appropriate guidance is issued to auditors on how they should respond to these developments . An issue which should be kept under constant review is the impact of existing and proposed accounting standards on realized and distributable profits under the Companies Act 2006. The current ICAEW /ICAS guidance on such profits runs to 173 pages which is in itself a clear indicator of a high and perhaps excessive level of complexity for both directors and auditors to understand and of the possibility of mistakes being made. Perhaps there is scope for an expert system to be developed to assist directors and auditors so as to reduce that possibility . Other areas that should currently be kept under review given their huge potential impact on balance sheets are the audit implications of IFRS16 on leases and the proposed changes to the IFRIC 14 rules on defined benefit assets.

(x) One of my concerns is that some of your Review's questions seem to be linked to possible changes which would either frighten off challenger firms or actually result in a deterioration of audit quality . One of these possible changes appears to be to widen the auditor's liability to third parties which seems to be a rapid way of reducing even further the number of audit firms or individuals who might otherwise want to become auditors of larger entities . I am also rather surprised that given certain audit failures no questions have been asked about what could be done to build on ISQC 1 on 'Quality Control for firms that perform audits and reviews of financial statements , and other assurance and related services engagements ' and ISA 220 on 'Quality control for an audits of financial statements ' . From my experience nationally and internationally , very much depends on the calibre , experience and robustness of the members of a firm:

*providing technical opinions;

*supplying genuine and in depth industry expertise particularly in high risk sectors including different types of financial institutions ;

*reviewing US GAAP and GAAS compliance that is essential for many of the very largest UK companies which are not only listed on the London Stock Exchange but also on one of the US markets ;and

*performing 'hot reviews ' of audits of public interest entities before they are signed off .

I remember that these aspects of quality control can be improved by outside hires from other firms

within or outside the network , standard setters and from audit and financial institution regulatory bodies .

It would therefore be useful for the new regulator to ask to see the the “development and resources plan “ for such quality control activities and to encourage the flow of its own staff at a senior level into audit firms and in particular into challenger firms and those with worrying levels of non compliance .

(y) The time has come for the UK ethical standards for auditors to contain a ban on non audit services being provided by auditors to FTSE 350 and large UK private companies that they audit thus taking away completely from the audits of the largest UK companies the perception issues that the selling and provision of non audit services may undermine audit judgments and culture . Such a ban would clearly meet the ‘bold action test ‘and be far more effective than the types of Chinese Walls that the CMA is recommending which would be a bureaucratic nightmare , would do nothing to encourage challenger firms to enter the audit market for large UK companies and would actually reduce audit quality by making multidisciplinary auditing more difficult .

(z) As part of the impact analysis consideration should also be given specifically to the impact on the London Stock Exchange . The CMA already seems to have put Government on the brink of introducing a piece of French bureaucracy , mandatory joint audits , which would involve most FTSE 350 companies being put to a lot of cost and trouble for something which is unproven and risky at precisely the time when UK business needs to be getting on with growing the economy with the minimum amount of bureaucracy . FTSE 350 and smaller listed companies aspiring to become FTSE 350 companies have more than enough distraction at present given the continuing uncertainties relating to Brexit . Also requiring most FTSE 350 companies to have a joint audit would put an impediment in the way of virtually all foreign companies (except presumably those that are French)being able to list on the London Stock Exchange thus severely reducing the capacity of that market to grow . Given this back drop it is important that any further regulatory changes that may be made do not have the unintended consequence of making the London Stock Exchange less attractive to issuers or of adding bureaucracies that make U.K. companies less competitive over the extremely difficult economic and political period ahead.

Turning to the detailed questions themselves , my answers are set out below :

Q1 .For whose benefit should audit be conducted ?

“Shareholders as a class or body in general meeting as audit should be an integral and essential part of the governance process .

As Lord Bridge of Harwich indicated in the leading House of Lords judgement in the landmark case of *Caparo Industries PLC v Dickman* in 1990 , a statutory audit of a company enables the shareholders to exercise their class rights in general meeting . This judgement reaffirmed that there could not be a duty owed in respect of “liability in an indeterminate amount for an indeterminate time to an indeterminate class “ as set out in the *Ultramares Corp v Touche* 1931 judgement of Justice C.J Cardozo in the New York Court of Appeals . Applying various principles the Law Lords ruled unanimously that the defendant auditors owed no duty of care to potential investors in the company who might acquire shares in the company on the basis of the audited accounts .

Whilst investors might want a wider duty of care and claim that a wider duty of care by

auditors might improve audit quality , the reality would be “a rapid road to an avalanche of claims by investors”, the total deterrence of challenger firms , the exit of all of the few remaining auditors of large companies and when no auditors are left the collapse of the London Stock Exchange through the resulting absence of audited financial statements and therefore of the whole U.K. economy . It would also clearly fail one of the three tests created by the Caparo judgements namely that liability should be fair, just and reasonable .

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

As Lord Bridge indicated in his judgement audit should be designed to enable the shareholders as a class to exercise a collective interest in the proper management of the company ...and to call the directors to book and to ensure that errors in management are corrected.

Too much play is made of the term “degree of confidence “ in the entity or in the financial statements as the audit process should be about ensuring that “red flags” are raised in the financial statements and in the auditor’s report as appropriate about the management of the company .

I would suggest that the Law Lords’ unanimous Caparo judgements should be mandatory reading for the review groups .

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 ?

No , but Lord Bridge’s judgement should be given more prominence perhaps by way of a ministerial statement .

Q4 .Do respondents consider there is an expectations gap?

Yes but the term “ delivery gap “ is a more productive way forward .

Q5 .If so , how would respondents characterize that gap ?

There is a need for auditors to perform more work on ,and to report more informatively on material fraud , the going concern condition and on material misstatements arising from illegality particularly relating to distributable profits .

Q6 .Is there also a significant ‘delivery ‘ or ‘quality ‘ gap between auditors’s existing responsibilities in law and auditing standards and how those responsibilities are currently met ?

There is a ‘delivery gap ‘between existing responsibilities in law and auditing standards and on occasions a ‘quality gap ‘ in how responsibilities to the law and standards are met. Part of that gap arises from the inadequacy of the enforcement of relevant statute , namely section 501 of the Companies Act 2006 which is intended to prevent auditors being supplied knowingly or recklessly with a statement of information or explanations that is misleading , false or deceptive in a material particular .

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

There could usefully be a role for the auditor in providing assurance on wider information presented by the directors such as the statement on how they have exercised section 172 of the Companies Act 2006 in taking account of how regard has been given to other stakeholders , KPIs and non financial measures (if clearly defined), internal control, the payment of invoices , gender information and on sustainability and environmental information.

Q8 .Can the level of assurance that an audit provides legitimately vary in different circumstances , for example depending on the business sector in question , and the nature of the entity's business risks ?

Yes and this would point the way forward to a more graduated rather than a binary type of reporting . It also indicates the need for more audit guidance at the industry sector and sub-sector level .

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

Yes but it needs to be recognized that the scope and nature of internal audit is entirely for the board and its audit committee to determine .

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

Only to a limited extent as there will always be a perception that there is a moral hazard in relying on an internal audit process which is scoped by the directors .

Q11 .Do eligibility requirements for external auditors focus too much on independence at the potential expense of market innovation and the quality of the audit product ?

Yes but there is a misperception that there is not enough choice of auditor because of ethical standards . In practice audit appointments are much larger in fees than most non audit services and so accountancy firms want those appointments . Also in the run up to an audit tender possible alternative auditors are put on notice to get 'independence ready 'as they go through a tender process with a sufficient choice of auditors . There is however scope for market caps for Big 4 firms , putting more challenger firms on tender lists and for challenger firms being appointed as auditors.

There is also a need for auditors to be more imaginative in how they plan audits. An enabler for this would be exploring how to reduce the box ticking required of auditors in areas which do not create significant risk of misstatement . Instead more emphasis should be placed on:

- * Earlier identification of ,and response to, significant risks;
- * The identification of more industry sector and sub-sector significant risks;
- * More reliance on sources of contradictory evidence provided from other sources than management rather than merely extending auditing samples in response to identified significant risks;
- * The scanning of accounting populations to identify sub populations of audit interest and suspicious

items rather than mere reliance on the testing of a sample and on the extrapolation of sample results to a whole population;

*Even greater use of other disciplines within a multidisciplinary practice to challenge the financial statements and other information within the scope of the auditor's work . Such disciplines include industry experts , IT specialists , forensic practitioners , different types of tax practitioners ,actuaries , economists , regulatory specialists , debt specialists and environmental and sustainability reporting practitioners;

*The development by industry specialists and economists of a new breed of industry Practice Notes which are directed particularly to the sectors and sub sectors where there is an increased risk of misstatement arising . These could focus more industry risks, on specific tests for material fraud risks relevant to those sectors , sources of audit evidence which are related to key areas of judgment but which are not generated by company management thus helping auditors to become more sceptical on the basis of alternative sources of evidence that are potentially more challenging;

*More focus paid during an auditor's training to learning to say "no " and to identifying clues from body language , their talk and behaviours that are indicative that someone is lying . Many years ago my audit team and I put ourselves on notice that there could be a fraud at a company that we were auditing based purely on the body language , talk and behaviours that we had noticed , and then went on to uncover a collusive fraud .

'Audit only firms ' would be a massively retrograde step in terms of audit quality as it would make it much more difficult to access industry experts , forensic expertise, tax practitioners , actuaries ,regulatory specialists, economists and going concern and debt management expertise.

Q 12.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 again .

Q 13. Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified ?

Yes. But there is a need to avoid adopting the US COSO approach which creates a mountain of box ticking . Useful additions to the current guidance for directors on 'Risk management , internal control and related financial and business reporting ' would be more explicit references to identification and prevention of fraudulent reporting , bribes and facilitation payments and the determination of realized and unrealized profits , distributable and non distributable reserves and the application of prudence particularly in the setting of dividends and bonuses .

As a general principle extensions to the scope of the auditor's role should be accompanied by a corresponding expansion of the role of the directors . Otherwise a moral hazard could arise by which directors would assume that they have no role to play in particular areas because they are matters just dealt with by the auditors .

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 publically these views?

Yes but where they relate to the possibility of material misstatement.

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

No. It is too binary in nature rather than graduated .

Q16. Should there be greater transparency regarding “events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern “?

Yes but this should apply to disclosure requirements for companies and not just auditors’ reports .

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

Yes.

Q18. Should the statement be subject to assurance ?

Yes.

Q19. Who might be capable of giving such assurance ?

Audit firms which have a multidisciplinary capability.

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

Yes but it needs to be the subject of a graduated rather than a binary firm of reporting . This would need to explain that guarantees cannot be made about the future.

Q21 .Would audit or assurance over financial and non- financial information outside the annual financial statements (for example KPIs or non financial metrics , payment practices or half yearly reports) enhance its reliability and therefore be of benefit to users ?

“Yes “ for KPIs and non financial metrics which are capable of audit for the benefit of the shareholders as a class but “no “ for half yearly reports as there would probably be insufficient time to audit them .

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

Section 172 statements , payment practices, environmental and sustainability information and gender information thus responding to the increasing recognition of the importance of these issues .

Q23 .Do respondents agree that the value and quality of the audit product should be considered

separately from the effectiveness of the audit process ?

No.

Q24 .Do respondents consider that emphasis placed on ‘ completing the audit file ‘ for subsequent FRC inspection can eclipse the desired focus on matters requiring the exercise of considered judgment ?

Yes .Audit checklists have become far too long and audits need to focus more on the identified significant risks and the key accounting judgments .

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

Much more value to the users would arise.

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

Yes.

Q27 .What would prevent such disclosures becoming boilerplate ?

Continued messaging by the new regulator.However the level of variety of the extended audit reporting is commendable and is an area where the UK is leading the world .

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

Despite claims to the contrary , the FRC auditing setting process has not been “producer led “within the UK and Ireland This seems to ignore the fact that the Chairs of the FRC Audit and Assurance Council and prior to that of the Auditing Practices Board have been non auditors who have been keen to ensure that they have not been captured by the firms .Likewise the Chair of the International Auditing and Assurance Standards Board is a non practitioner and half of its membership are public members or non practitioners .

Q29 .What role should auditors play in determining whether 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 ?

Auditors should continue to audit whether profits are realized and distributable but the disclosure of such profits in financial statements should be required by the Companies Act to make the determination of distributable profits a more explicit area of responsibility for directors and for consideration by the shareholders as a body.

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 ?

Yes. There is a need for clear requirements in Company Law for both the disclosure and auditing of distributable profits.

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

Definitely yes . It would also be helpful if bribes and facilitation payments could also be required to be specifically disclosed in audited financial statements and in written representations to the auditors . This would help address another key area of potential illegality .

Q32 .How do auditors discharge their obligations 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?

By tests .The existing statutory requirements are appropriate but there is scope to improve the communications from whistleblowers to auditors in respect of fraud and other irregularities .

Q33 .Should there be more open dialogue between the auditor and users of their reports ?For example , might an annual assurance meeting open to all stakeholders might prove valuable ?

There is scope for meetings with shareholders to discuss aspects that may be of relevance to the shareholders as a body or class . However there would be a need for auditors to avoid passing on price sensitive information that should be recognized .

Q34 .Should more of the communication and resulting judgments that occur between the audit committee be made more transparent to users of the financial statements ?

Yes but only in relation to material matters .

Q35 Should there be enhanced elements to the extended audit report such as an obligation to update on key audit matters featured in the previous audit report?

Yes.

Q36 .Do you believe that users' expectations of the 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 ?

I think that most shareholders rightly believe that auditors have a duty to detect material misstatements arising fraud . This responsibility is already clearly set out in auditing standards .

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

Yes but the following points need to be borne in mind :

* Auditors should be encouraged to incentivize whistleblowers who report fraud and inappropriate accounting .

* There should be more focus on industry Practice Note guidance identifying relevant frauds ,useful tests and sources of evidence independent of management at the industry and sub sector level .

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

This clearly already happens when auditors come before disciplinary schemes or court cases for negligence . The current approach involving expert witnesses giving evidence on the specific and detailed circumstances of the case in line with normal judicial type processes works sufficiently well. Any attempt to devise a generic ‘reasonable person ‘ test would be likely to be too broad brush .

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

Yes but corresponding guidance needs to be given to directors by way of an update to the FRC guidance to directors on ‘Risk management , internal control and related financial and business reporting ‘.

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

Yes.

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

It is not possible to see how any such limit could improve audit quality or effectiveness of audit but it could help the resilience of audit firms .

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 ?

No for the reasons set in the answer to question 1 above .The courts have already considered this issue fully and decided firmly that this would be unfair,unjust and unreasonable .

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 ?

It is not possible to see how changes in liability would result in favourable quality improvements . Audit partners are already subject to massive disincentives from producing poor quality audit work including becoming pyrahias within and outside their audit firm given that they are individually named in audit reports , poor appraisals, reduced pay , potential expulsion from their professional bodies thus removing their livelihood , huge personal fines and the risk of bankruptcy . There is a myth that as audit firms are LLPs that partners cannot be bankrupted but I recall that as a partner

my name was on various major property leases and that I also relied on the survival of the firm to pay tax on my behalf on past profits .

Q44 .To what extent (if any) are firms unable to obtain the desired level of professional indemnity insurance to minimize the level 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?

This question should be directed to the firms themselves .

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 first question should be directed to the firms themselves but I do not see how the use of technology would enable a higher level of assurance to be given particularly as companies' technology and cyber risks continue to rise . Ultimately humans are required to scope tests and to make audit judgments.

Q46 .In what way does new technology enable assurance to be given on a broader range of issues than is covered in a traditional audit?

This question should be directed to the firms themselves .

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

I am concerned about the growth of standard audit programmes which attempt to respond to the growth of auditing standards and audit regulation . I have also watched with amazement the reduction in audit quality scores achieved by the firms . It begs the questions as to whether there are too many "shall " requirements in auditing standards . I have been told (but this needs checking)that the " shalls" may currently exceed 700. When I stood down as Secretary to the Auditing Practices Committee of the Consultative of Accountancy Bodies in 1984 we had only two reporting standards and one brief operational standard which was supported by a number of operational and industry auditing guidelines . This was during an era when we had relatively few scandals about which we were certainly not complacent , an accounting concept of prudence which was well regarded , more confidence in the application of judgment and of a true and fair view and a set of auditing standards which worked for companies of all sizes . This appeared to work well and certainly generated more trust in audit than seems to be present today . It also engendered more focus on getting to the right answer and making the right judgments rather than just box ticking .

One of the consequences of the current audit inspection regime is that we seem to be creating a downward spiral of mistrust in the audit process . Perhaps more focus needs to be directed to areas of significant risk and perhaps more guidance (rather than standards)being issued on which risks ,useful procedures and external data sources that are relevant to particular industries , sectors and even sub sectors . There should also perhaps be more focus on addressing the concerns expressed by analysts and on more face to face reporting by the auditor at the annual general meeting.

I also think that we need to move away from describing the company and its management as "the

client “. In reality the client is , and should be , the shareholders as a body or class .

It would also be useful to have a standing sub committee of the new regulator to keep under review company law and accounting standards which may be of relevance to audit . We had such a sub committee in the 1980’s and it was helpful to recreate such a sub committee .

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 ?

There is always a need to learn from audit failures and to make improvements to prevent recurrences .

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

Yes but this can be improved by extending its scope and making the auditor’s report more graduated and discursive and less binary ,

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?

More narrative reporting should help reduce the loss of trust in audit and make the audit product more relevant to the shareholders as a body .

Q51 .What use do shareholders currently make of audit reports ?Are they read by shareholders generally ? What role does AI play on reading and analyzing such reports ?

The new style extended form of audit report is a great improvement . I doubt if they are read by the majority of investors many of whom invest via passive tracker funds . I would guess that some algorithms are used by analysts such as Credit Suisse Holt but ultimately there is no substitute for human skills.

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

Yes , but it should be recognized that any such dialogue is between the shareholders as a class or body and the auditors and that it should not create a duty of care with the shareholders as individual investors .

I support more communication between the audit partner and the shareholders at the AGM thereby enabling the shareholders to raise their concerns directly .

Q53 .How can 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 ?

Such ex ante anxieties can be expressed at meetings of shareholders as a body or class.

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

Shareholders also currently obtain assurance and other key insights (which may be favourable or unfavourable) from market announcements , profit warnings , quarterly reports, half yearly reports , analysts reports , trading condition updates , investor events , media reports , economic insights , political developments , investor webcasts and presentations available over the web , industry and sector information and corporate websites . During the BEIS Committee hearings one of the MPs indicated that he wouldn't trust an auditor to audit his fridge . This actually is a more apt analogy than perhaps the MP intended. One would not rely on checking the " sell by dates " on the food contents of the fridge once a year . There is a need to look continually at all the relevant sources of information throughout the year recognizing that they keep getting out of date .

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

As part of any new reporting on an amended version of the guidance on 'risk management , internal control and financial and business reporting ' . It needs to be borne in mind however that before its collapse Enron was viewed as an example of good governance .

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

This is harder than applying scepticism with the benefit of hindsight .But ultimately we have got to get back with greater vigour to the old concept that " external evidence is better than internal evidence " .

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

Auditor's remuneration is normally based on time spent and it may be useful to know by how much the fee had to be increased to cope with problems encountered .

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

About right .

Q 59. Would users of financial statements wish more detail on the make-up of audit fees ?

A trend towards more detail would result in more lowballing and a consequential reduction in audit quality .

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

It depends on how large corporates react to calls for changes in audit fees to respond to any moves to joint audits , increased and more costly audit regulation under the new regulator, more work by auditors if required to expand their work on internal control and other areas , more frequent tendering , a continued trend towards higher fines and penalties and increased litigation costs if liability is widened . I would guess that as large corporates are usually effective and tough negotiators any 'audit only' firm's profitability and resilience would diminish which could endanger the UK audit industry.

Let me know if you wish to discuss these comments and answers with me .As you will appreciate some of my points may also be of relevance to the implementation of Sir John Kingman's Report and you may wish to forward a copy of this submission to your colleagues working on that project. I wish both these projects well .

Martyn E. Jones