I'm inspired to write into this committee because there has been a huge amount of media discussion and political comment in this area but, in my opinion, very little input at all has come from the individuals who work in the profession. I'm sure there has been huge amounts of input in the way of official responses from the major players in the market, but I think there's always so much value in talking to people whose day to day focus isn't leadership and profitability, but actually auditing companies.

For me, the BIES select committee appeared an exercise in hyperbole and a competition for which MP could get the best pre-prepared quote in. The CMA seem to have focussed solely on the biggest market (FTSE 350) and therefore presented a raft of findings which might make sense at this level, but completely overlook the ramifications of the introduction of such measures for all other audits. Then the Kingman review seemed to me to be a lot more governance focus, but the findings have been used as a stick by the media to beat up our profession regardless. When I realised this review was taking place, it resonated with me greatly that the scope of the review seemed exactly what was needed to provide some clarity and, with the implementation of the right recommendations, hopefully restore some much needed confidence in the profession.

I therefore saw this as an excellent opportunity to send in some personal thoughts (absolutely no way indicative of the view of the firm I work for) about the scope areas you've defined. For your benefit, I'm a senior manager at Deloitte, having worked at the firm in an audit & assurance capacity, mainly with Private (non-listed) clients since graduating from university in September 2011.

My responses as follows:

- the purpose of audit and for whom it should be carried out
- whether its scope and purpose should be widened and strengthened to meet changing expectations of audit

For me these scope areas are one and the same.

To illustrate my thoughts on this area, I felt it would be useful to snip in the top rated comments from the bbc article produced on the day of Patisserie Valerie stating it required a capital injection (https://www.bbc.co.uk/news/business-45824285):

38. **briblogg**
11 Oct 2018 14:24

"In its most recent results statement in May, the firm said it had cash reserves of £28.8m."

Once again auditors have totally failed in their duty to the company, to investors and shareholders and the staff.

Just the same as Carrillion and many banks just before their crashes but on a smaller scale.

It is about time some people went to jail for their incompetence/corruption in audits.

Report **Link to** ↑392 ↓10

3. **Nick**
11 Oct 2018 14:16

It sounds to me like the auditors should be questioned. Missing a 'material shortfall' is unforgivable.

The financial director should be fined and banned from acting on any listed company board for the next 7 years aswell. Gross mishandling of the company finances.

Report **Link to** ↑315 ↓8

14. **logansdone**
11 Oct 2018 14:19

Not only baked the cake but cooked the books it seems.
Which audit company is responsible, no doubt one of our 4 friends again

Report **Link to** ↑302 ↓7

Of the reactions that have drawn the most 'up' votes. I would draw out 5 key observations which I'd like to explore in more detail:

1) People expect auditors to identify material errors.
2) There should be punishment where something goes wrong.
3) Who has audited a set of financials doesn't really matter.
4) People draw comparisons between failures in companies, irrespective of what might have caused that failure.
5) People see a company fail and immediately blame the auditor.

Point one should be non-controversial. If an audit can't spot a material error, it's not fit for purpose. However, I think two key qualifications are needed here. Firstly, the definition of 'material'. Clearly, there have been changes about the level of disclosure of materiality levels and their basis, which I think should help to bridge the expectation gap. But I still think there's a fundamental challenge when we're thinking about members of the public, staff and smaller shareholders about their expected size of a business' materiality against what we've defined it to be. This point links to my second one which is where is our material error? One area I'd want the committee to explore, is I feel we spend a lot of time on audits focussing on stuff because it's complicated or the accounting is difficult or there is a big judgement. I'm thinking areas we require specialist involvement from outside the audit team, like complex financial instruments, pensions, taxation etc or areas where it's easy to manipulate the accounting and create big material swings in results but fundamentally are accounting judgments the answer to which doesn't really impact whether your business is really generating cash (capitalisation of intangibles, impairments etc.). Purely from an 'expectation' perspective, I think there would be a lot more sympathy if certain accounting judgements are wrong against, for instance, a factual part of the balance sheet (cash springs to mind in the PV example). My perspective would be to question whether a one size fits all concept of materiality is appropriate, or might there be a more focussed way of assessing what material means and therefore where auditors spend their time.

The second comment I can't really have too many complaints about either. There has to be accountability in any walk of life and where audits are obviously erroneous, why shouldn't proportional punishment be forthcoming. My main comment would be I don't think a company needs to go under for actions to be taken against an audit firm/partner/key staff members. Our regulator needs to be proactive, and take action where flaws are found as part of routine investigations as well.

The third observation I think is particularly reflective of where we find ourselves as an industry. As the third comment highlights, 'no doubt one of our four friends again'. Of course, it actually wasn't, this was a Grant Thornton audit – but that doesn't seem to matter. For every high profile audit failure, it appears to be the sector, not the firm who has conducted the audit, which gets hurt. Hence, all audits must be held to the same standards of accountability, linking somewhat to the point above. The critical point I would draw out is that so much talk seems to be about the FTSE350 and the way it is audited, that the argument risks losing sight of the damage of non-FTSE companies going bust can cause to audit. I've picked this case because it's the one that's made the news and been spoken about to me more by my friends – but the business was AIM listed. As a brand, PV was identifiable and relatable to the public in a way that Carillion was not. So it's failure has reflected very badly upon audit as a whole and I feel may well have done in a similar fashion regardless of whether it was a private or listed business.

To further explore my next two observations, let's look at the top comment in a bit more detail. The bbc article talks about, and links straight through to, the May results statements where the £28.8m of cash reserves was disclosed. The comment, quoting this passage, then goes on to highlight how, 'once again auditors have totally failed in their duty'. However, this May results statement refers to unaudited numbers as at end of March 2018. The only audited numbers in that statement refer to the year ended September 2017. Thus, this comment was wholly unfair on the auditors and factually inaccurate. The comment though was the most popular, which indicates an opinion that the auditor's work in relation to the period ended September 2017 should have been capable of preventing inaccurate presentation of unaudited future results.

In short, where a company fails, the natural inclination appears to be to look at the audit and instantly deem it a failure. I can't pretend to be an expert in the causes of the failures of Carillion and PV, but my high level understanding is that the first failed as a result of serious strains on its cashflows as a result of a number of individual project failures, delays and unprofitable contracts and PV as a result of serious strains on it's cashflow as a result of ongoing underperformance hidden fraudulently by the company's management. On the face of it, there's a strong case that the auditors may have been significantly more to blame in the PV case than that of Carillion but in focussing on public perception, I don't think there's a great deal of difference. The companies have gone down and the focus turns to the audit.

As such, when we talk about the purpose and the changing perception of audit, it boils down to the extent to which an audit's purpose to is to verify a company's status as a going concern and for what time period. There are a number of critical challenges I'd draw out here:

- Cost and appeal of an audit. Fundamentally, we are a business and we are auditing businesses. It might sound simple, but if an audit is changed for going concern to become a significantly greater area of focus & challenge, then the riskier, more expensive, audits become those companies with less ability to pay for it.
- Forecasts aren't factual or easy to audit. The quality of forecasting I come across in businesses is often very poor, commercial acumen of the preparing accountants is limited and where we assess historical accuracy it's generally pretty weak.
- Management will always place significant pressure upon auditors who fundamentally question going concern. Why wouldn't they? It's extremely easy to say that auditors should be stronger, a lot harder in practice when our only real recourse is to resign.

Personally, I don't like where we've ended up. As currently defined, our job boils down to providing assurance at a material level, of the factual accuracy of a set of financial statements as a specific time period. I believe an audit should do that and where it does not, necessary, decisive and confidence inspiring action should be taken. The reality though is that society's perception of an audit doesn't meet this definition. There is an inescapable link between the failure of a company and a failure of the audit. I think it dramatically undermines confidence in the audit sector as a whole due to a clear expectation gap I'm not sure can be eliminated whilst auditors conclude as we do currently on the assumption.

Is it possible that we could audit a company without concluding on going concern at all? I'd consider that unlikely, but I think it's worth considering if a separate, or a second, view should be taken on the financials of a company meeting certain criteria. I don't necessarily like the concept of joint audits – but is there a case of saying that a second party needs to provide specific sign-off regarding going concern? My suggestion would be that such a sign-off wouldn't be boilerplate but this second party could provide written analysis which goes beyond, or challenges, management's own financial statement disclosures on going concern. Separate firms, who are independent to the auditor, who are experts in assessing and challenging going concern assumptions and going concern alone within the financials.

Undoubtedly, if not universal, criteria of this nature would need to be very well defined. Potentially a universal application across all companies based over a certain size, or meeting financial metrics which prompt a 'greater than normal' risk over going concern. But I genuinely do think we're in a position where expectations around the purpose of an audit have far surpassed the reality of what we currently do regarding going concern. For me, the direction of travel has gone too far for firms to try to independently adjust for this gap and an overhaul regarding it is required. Requiring sign-off independent to the audit would visibly remove this link and allow audits to continue to focus on what they have always done, and in my opinion nearly always done very well, and that's focus on providing assurance around the historical information presented in a set of financials.

- how the quality of the audit process and product could be improved

What I think hurts the most and, what I find most confusing, about where audit now finds itself is that when I joined Deloitte in 2011, I believed I was joining a company seen as being top quality, providing a gold plated audit that was recognised as a world class product. Nothing in my first 4-5 years at Deloitte ever made me question that image. I perhaps in all that period met 2-3 people who were negative about my career choice but, generally, the name of the company and the job I did came with a solid degree of respect.

The real irony in this change in perception, is that I would state with every bit of conviction I have that audit quality has improved significantly since I started. One example which stands out is our audit response to the presumed significant risk of management override of controls. When I joined, the testing of journals involved asking clients for a manual journal folder, handing it to the most junior member of staff and letting them select a random sample of 10 journals to test. Inevitably, 10 easily understandable journals with lots of support attached were selected and we ticked off our sig risk response as complete. Our approach now involved reconciling the entire journal population, using an analytic to select key journals of potential audit interest based on characteristics we define and testing all journals back to support which have triggered our test.

Similar advancements can easily be evidenced across all our testing areas, our risk assessments and our approach to controls. We fundamentally are not an industry that have stood still. Technology we've developed provides more and more insight into companies and focusses our audits on the real areas that matter. Of course we are still evolving – I never expect that to stop – and there are certainly areas that can be improved (see below), but the question I really can't answer is how perception can have moved to a point that our product is broken, when it represents a much better product than it was when it was seen as world class.

Where I'd have biggest concerns remains around whether best practice is adopted consistently – across the whole practice, firms and their individual offices or even departments. As a quality reviewer within Deloitte, I've seen so much best practice and innovation but I've also seen a considerable number of files where fundamental changes in our methodology or approach have been missed. Sometimes it can be as localised as one London department spending a group afternoon training session focussing on an innovation and adopting it, whilst another takes a bit longer for initial adoption and therefore finds files not doing things well after it became part of our methodology. This happens, and it's why we have quality review to address it before sign offs. But when I think of the variances we have as locally as two audits in the same office, it does raise the question of how quality can be achieved across the board.

I know some firms outside of the Big 4 have raised concerns about how they can compete regarding technological advances. And I'm sure there is a desire amongst audit companies to improve the quality of audits across the board. But, at the end of the day, we are competitors. We want to create the best product we can to sell to the audit committees and management who approach us. If a firm can't compete on quality, their only other routes to employment are connections and price. Neither are a place the market really wants to find itself. I'd say it's rarer than it was that audits are won solely by relationships and the deal settled over a pint; though it would be wrong to say it doesn't still happen. Then, if we're competing on price rather than quality, that's clearly the fastest route to malpractice and failure.

The answer links to our regulator. As I said above, bigger and better punishments are needed where mistakes are identified; and not just in the high profile cases but in all reviews. But we need to know what the regulator wants us to deliver and to deliver on that.

- whether audit findings could be better communicated

The question is to whom? I would state with confidence in almost all instances that an audit committee is given full visibility of all key audit findings and issues. I would equally say very little which an audit committee might see and digest would appear in any set of financial statements, listed or otherwise. The question to be answered is who needs to see what and why and once that's clear, effective communication should follow.

- the role of audit within wider business assurance and in relation to directors' legal responsibilities

I would say that the vast majority of companies who engage a big 4 auditor are looking for that gold standard audit product and that extends well beyond us simply signing an opinion and into providing insight into their business. My general experience is that this works well and audit committees, or management in the case of smaller clients, will challenge us for our opinion about the quality of their control environment, both financial and operational where relevant. Not being a director, I wouldn't feel qualified to comment on the second part of the question.

- the role of audit in detecting fraud

I remember when I started training how much of the ICAEW content was focussed on this area and how an audit fundamentally isn't responsible for detecting lower level fraud and the existence of the 'expectation gap'. As referenced above, I'm comfortable this expectation gap has moved fundamentally now to be focussed around the going concern assumption. I don't think there really is any expectation that an audit should be detecting low level fraud and, naturally, our procedures don't try to do this.

The key when we're talking about fraud is at a more significant level, which ultimately is likely to be financial statement fraud, where the role of audit should be absolutely clear. One observation I would draw out in this regard is that the vast majority of audits will have very limited uncorrected misstatements. However, most audits will have much higher levels of corrected misstatements – i.e. adjustments posted between management's original numbers and those presented in the financials. Very very rarely however would we describe such entries as fraud, as natural presumption, for instance if something is missing, is that it's most likely an oversight or an error.

- auditor liability

Touched on this fairly comprehensively above that it's reasonable to expect when a job isn't done correctly or issues are noted that appropriate action should be taken. The only point I'd add is that if regulators are going to become more onerous and the level of liability increases, what does this do for the cost of audit? And if audits are going to become more onerous and the quality of company control environments is going to need to improve in response to the findings of the committee, how do audit firms recruit the talent to deliver the audits and companies find the finance personnel to adequately support their functions? I would describe recruiting quality finance professionals as the biggest challenge facing both my firm and my clients and the committee should be cognisant of that in thinking through their recommendations.

For me, the audit market needs certainty. Confidence can't be inspired by consistently being told we're failing and I'd appreciate if the committee attempts to call out some of the challenges we face and where some of the previous reviews (namely the BIES committee) have erred. So, the way I'd conclude is if you could set yourself three objectives from this review, it's to teach the politicians who govern us what we do, suggest the changes which will make a positive difference and give us the ammunition to show the world we still have a world class product.

Cheers,

Kris