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Brydon Review Secretariat
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Dear Sirs

Independent Review into the Quality and Effectiveness of Audit

Kreston Reeves LLP appreciates the opportunity to contribute to your review of the quality and effectiveness of audit, and the call for views published by yourselves in April of this year. We acknowledge that is a high-profile topic at present, and this review will help to address concerns regarding the role audit has in providing confidence in the UK economy.

Kreston Reeves LLP is a firm of Chartered Accountants that is amongst the top 25 largest firms in the United Kingdom. Based in London and the South East, we predominantly operate in the SME market providing audit and other accountancy services. Our client portfolio does though extend to include AIM-listed companies. We are a member firm of Kreston International, a global network of independent accounting firms. We are also a member of the Association of Practising Accountants and the Forum of Firms.

We would like to echo the comments made by the Association of Practising Accountants in their response to the Call for Views dated 28 May 2019, but consider that the importance of this review is such that it is appropriate to add our own comments to the discussion in order to ensure that the views of mid-tier firms such as ours are heard.

Many of the issues confronting the auditing profession today derive from high-profile business failures and concerns regarding audit quality of public interest entities. Any reforms that are deemed necessary to address these concerns are likely to have significant implications for the SME market in which we operate, and thus we consider it vital that the review takes into account the views of mid-tier firms such as ourselves and that any emerging proposals are appropriately proportionate. Our detailed responses to the questions raised in the Call for Views are contained in Appendix 1.

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Key points

It is clear to us that the demands when providing assurance in respect of Public Interest Entities are considerably more onerous than those for the SME market with which we are more familiar. It is regrettable to us, but it would appear that it is time to consider whether a single audit approach for all sectors of business is appropriate given the reforms that are necessary to meet the concerns of the users of the financial statements of Public Interest Entities. The cost of such reforms is likely to have an impact on audit cost that the SME market would not be willing or able to bear.

In our experience, audits of SMEs are high quality, well regulated and generally meet the needs of the users of financial statements. We recognise the need for continual improvement, development and innovation. We wish to see emerging proposals to address failings in the audits of Public Interest Entities to have a proportionate impact on SMEs.

The case for reform though is a compelling one, and as such we can support many of the proposals outlined in the Call for Views and hope that if implemented will hope to restore the public's faith in the audit profession, a profession that we continue to be proud to be part of.

If you have any questions on the contents of this letter then please contact Peter Manser at the address shown.

Yours faithfully

Kreston Reeves LLP

Appendix 1

Independent Review into the Quality and Effectiveness of Audit
Call for Views

Responses to specific questions

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

An audit should be conducted for the benefit of the identifiable users of the financial statements. We acknowledge that in today's corporate environment this goes beyond the entity's shareholders/members but will also include other interested parties including employees, suppliers and customers, although the current legal framework for audit does not currently recognise this.

The audit process should enable the users to have confidence that the financial statements have been prepared, in all material respects, in accordance with the underlying reporting framework. This enables better decision making by the users when considering the stewardship of the entity, investment decisions and in many other areas where an appreciation of the financial performance of an entity is of relevance, all of which lead to improved business confidence.

Question 2
Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?

For the purposes of this consultation we are of the opinion that the audit should be designed solely to provide confidence in the financial statements, and by extension the entire annual report. In this regard we would welcome an extension to the scope of the audit to include the narrative reporting that accompanies the financial statements.

The audit can form part of a package of measures that can provide confidence in an entity. We do not believe though that it is the role of the auditor to provide additional assurance beyond the audit of the financial statements.

Question 3
Should UK law be amended to provide greater clarity regarding the purpose of an audit, and for whom it is conducted? If so, in what way?

We agree that there is insufficient clarity in legislation regarding the purpose of an audit, and that if an audit is to be required by statute it should be clear as to what precisely is required. Such a move would assist in helping to eliminate the expectation gap that currently exists.

We believe that legislation could be improved by providing greater certainty on the following:

- *The meaning and purpose of an audit.*
- *For whose benefit an audit is conducted, and thus to whom the auditor owes a duty of care – whether it is the entity's shareholders or a wider body of users of the financial statements*

We believe that consideration should be given as to whether the nature of an audit should be considered to be the same for all entities, or whether the needs of Public Interest Entities (PIEs) are such that the audit of such entities is fundamentally different from the assurance needs of other non-PIEs.

Question 4
Do respondents consider there is an expectation gap?

Based upon recent media coverage of high profile corporate failures we believe it is clear that an expectation gap exists with respect to the audit of Public Interest Entities.

Our experience of advising SMEs suggests that the expectation gap is not so prominent in this sector of the market, where there would appear to be better understanding by the users of financial statements of the role of audit as part of the reporting process.

Question 5
If so, how would respondents characterise that gap?

We would characterise the expectation gap as being damaging to the audit profession, and an area that needs urgent review so that the reporting framework adequately meets the legitimate needs of the users of financial statements.

The expectation gap arises in several respects:

- *Notwithstanding our response to Question 1 above, at present the audit is conducted primarily for the benefit of a company's shareholders so that they are able to assess the stewardship of the company, as evidenced by the audit report which is addressed to them. This is despite auditors being fully aware of the existence of other users of the financial statements.*

  With respect to Public Interest Entities the variety that exists amongst the users of the financial statements, each with their own reasons for being interested in the financial performance of the entity, makes it difficult under the existing framework for the audit to address all of their needs and expectations.

- *As noted in ISA (UK) 200 and reproduced in the Call for Views, the scope of the audit does not extend to providing assurance on the future viability of the audited entity. This is in clear contrast to what would appear to be one of the primary uses of the financial statements – to provide an indication as to how the entity is likely to perform in the future.*

  The audit is primarily a review of historical financial performance. Although future expectations can be reflected in financial statements and thus addressed by the audit, the wider public perception appears to be that an audit is designed to provide assurance on the future performance and particularly the viability of a company.

- *The concept of materiality is of vital importance in audit, and one that does not appear to be well understood. This has helped lead to the perception that the role of the audit is in part to detect and prevent any fraud from occurring. Although fraud may be commonplace, in most occasions it will not be material to the financial statements and thus of little relevance to the audit. Yet the auditor is often believed to be culpable whenever fraudulent activity comes to light, despite it actually being the responsibility of client management to have a system of internal control in place designed to prevent and detect fraud.*

- *Despite the law being clear, it is often thought that the auditor is responsible for the financial statements. It is of course management's responsibility to prepare and approve the financial statements. It is not surprising that this is often the case, as company directors are not required to have any accountancy knowledge, and often delegate the preparation of the financial statements to others, which for non-PIEs may be the auditor. Also at present there is little oversight of directors and their role in preparing the financial statements, something we expect the reform of the Financial Reporting Council and its regulatory powers to address.*

Question 6
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?

We do not have any evidence to suggest that there is a significant delivery or quality gap in the area of the market for SMEs in which we primarily operate.

We consider it unfortunate that a small number of high-profile incidents involving Public Interest Entities has resulted in the perception that quality issues within audit are widespread, although we do accept the need for reform to ensure that audit remains fit for purpose.

Question 7
What should be the role of audit within wider assurance?

We hope that audit will continue to be the gold standard against which other forms of assurance are judged.

We acknowledge though that increasing greater assurance is being demanded in areas that are not being addressed currently by the audit process, for example in areas such as environmental reporting or in respect of an entity's culture. Providing assurance in these areas will prove challenging to many auditors, not all audit firms have the resources available to develop specialist advisory teams in these areas. We accept therefore that audit may prove to be only a part of a wider range of assurance that is sought, but that it is likely that it will remain the primary form of assurance available when assessing an entity's financial performance and future viability as a going concern.

Question 8
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?

We believe that this is a key issue that your review needs to consider, whether a single audit framework can be expected to consistently provide the level of business confidence that is demanded regardless of the size and nature of the entity concerned.

The current approach, that an audit is fundamentally the same regardless of the entity concerned, needs to be questioned. In reality there are clearly vastly different assurance expectations between Public Interest Entities and those privately-owned businesses, charities and other entities that require audit. Yet the framework of auditing standards is the same for all. The reforms needed to address the expectation gap that exists in respect of the audit of Public Interest Entities are likely to be overly-onerous and expensive to introduce for other, less complex entities and thus a more proportionate approach is required.

If it is possible for there to be different financial reporting frameworks that address the different requirements of entities of differing sizes of sector, then we believe that it is possible to do similar with the varying assurance requirements.

Question 9
Are the existing boundaries between internal and external audit clear?

We believe that the existing boundaries between internal and external audit are clear.

Question 10
To what extent should external auditors be able to use evidence obtained from work performed by internal auditors in drawing conclusions?

Provided that internal audit work is performed to an acceptable standard, equivalent to the auditing standards followed by external auditors, and is undertaken by those with sufficient independence and objectivity, we see no reason why the external auditor should not be able to place reliance on the work performed by internal auditors.

We believe that consideration should be given to removing the prohibition currently in place preventing direct assistance being provided by the internal audit function to the external auditor, provided that the external auditor continues to have overall responsibility for determining the work to be performed and for the audit opinion expressed.

Question 11
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 independence of the external auditor and the objectivity it brings is a key factor in the credibility of the audit process, and we would not be in support of any changes that threatened this.

We do not see any causality between auditor independence and a lack of market innovation or quality.

Question 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?

Such a statement may prove to be of benefit to the users of the financial statements of Public Interest Entities, although we fear it may prove to be 'boiler plate' and ultimately be of little value.

As part of the annual report the statement would be subject to oversight by the auditor.

SMEs generally have a more straight-forward business model than Public Interest Entities, and we consider that a proportionate approach is required to ensure that SMEs are not burdened with additional reporting requirements that provide little additional benefit to the users of their financial statements.

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

With respect solely to Public Interest Entities, we believe there is merit in extending the auditor's responsibilities in order to assess the effectiveness of an entity system of internal control. As indicated in the Call for Views it is already likely that the auditor will be testing the system of internal control in order to be able to place reliance upon it, so such a move should not significantly affect the volume of audit work that is required, but would provide additional assurance to the users of the financial statements.

For smaller entities, where the auditor is less likely to place reliance on the effectiveness of internal controls, we do not believe that any change in the auditor's responsibilities is warranted.

Question 14
Auditors are currently required to report to audit committees their view on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?

We believe that the Audit Committee is the appropriate body to receive the auditor's view on the effectiveness of internal controls. Given the level of detail that such discussions involve we do not believe that it would be appropriate for full details of these discussions to be reported publicly. However as indicated in our response to Question 13 we are not opposed to some form of assurance in respect of the effectiveness of the system of internal control implemented by listed and other relevant entities being provided publicly by the auditor.

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

We believe that the current reporting framework does not adequately address the issue of going concern, given that the future viability of an entity is of paramount concern to the users of the financial statements. We are of the opinion that the financial statements of Public Interest Entities should include disclosure of the directors' expectations on the future viability of the business over the longer term. This would build upon the current requirement of the UK Corporate Governance Code for entities to publish a viability statement, and by making it part of the financial statements make the statement subject to audit and thus subject to a higher level of assurance than at present.

At present the financial statements of companies are only required by accounting standards to disclose details of any material uncertainties that are thought to exist, rather than a more comprehensive outlook on the company's future prospects.

Question 16
Should there be greater transparency regarding identified "events or conditions that may cast significant doubt on the entity's ability to continue as a going concern"?

Yes! We hope that the changes to ISA(UK) 570 being proposed by the FRC will result in this being achieved, due to the additional reporting responsibilities being placed upon auditors to comment upon going concern issues in their reports. We do believe that any change needs to be proportionate, reflecting the differing needs of Public Interest Entities and other, less complex entities.

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

We believe that the existing requirements of the viability statement outlined in the UK Corporate Governance Code are broadly sufficient, but that it could be enhanced by ensuring that it covers a period longer than that often used as a basis for considering going concern issues.

Question 18
Should such a statement be subject to assurance?

As indicated in our response to Question 15 we are of the opinion that the viability statement should form part of the financial statements of Public Interest Entities, and thus by definition be subject to audit.

Question 19
Who might be capable of giving such assurance?

We see no reason why the company's external auditor would not be capable of providing the necessary assurance in respect of the viability statement as part of their audit of the financial statements.

Question 20
Is there a case for a more forward-looking audit? What would be the main benefits and risks?

There is a case for more forward-looking financial statements, as indicated in our response to Question 15, which in turn will require a more forward-looking audit.

A more forward-looking audit may address some of the issues that have resulted in the expectation gap arising, particularly in respect of future viability. By providing greater assurance on the viability statement, users can have greater confidence in areas such as investment decision-making.

Forward-looking financial information is by its very nature less reliable than historic information due to the reliance in place on the use of estimates for which little supporting audit evidence may be available. Any reliance placed upon forward-looking information by the users of the financial statements will need to bear this in mind, a fact that will need to be made clear within the audit report.

This extension of the role of audit, and the responsibilities of the auditor, would require reform of the current liability regime to enable auditors to be able to adequately manage the additional risks that this would present.

Question 21
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?

As already mentioned in our response to Question 2, we believe that the narrative statements included within the annual report by statute, such as the directors' report and strategic report, should be subject to audit in addition to the financial statements, rather than the reduced level of assurance that currently exists, as required by ISA 720. Such a move would enhance the level of confidence the users can have in regards to the reliability of the narrative reports.

We agree that the use of Key Performance Indicators aid the understanding of the financial statements, and through making these an intrinsic part of the financial statements greater reliance will be able to be placed upon them. It would be necessary to ensure that the basis upon which Key Performance Indicators are calculated is defined, either within financial reporting standards if generic or within the financial statements themselves where they are bespoke in nature.

Question 22
If so, what information might usefully be subject to audit or another form of assurance and why?

As indicated in our response to question 21 we believe that inclusion of the Key Performance Indicators utilised by management in their assessment of the business should form part of the financial statements, and be subject to audit.

Question 23
Do respondents agree that the value and quality of the audit product should be considered separately from the effectiveness of the audit process?

We agree with the position in the Call for Views that there is a distinction between compliance with the current auditing standards, and whether those standards result in an effective audit product that meets the demands of the users of financial information.

Question 24
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?

We appreciate the sentiment behind this statement, that the focus of the audit team may be to present what would appear to an independent eye to be a compliant audit file. Completing the audit file is important, but it must be emphasised that this must not be to the detriment of audit quality.

Question 25
What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?

We are of the opinion that a move towards a non-binary audit opinion would not aid understanding of the message the auditor is aiming to communicate, and that the current approach to reporting should be retained.

Question 26
Could further narrative be disclosed alongside the opinion to provide more informative insights?

As indicated elsewhere in our response, we believe that the scope of the audit should be extended to cover the narrative reporting. The audit report would need to adapt to reflect this, and in doing so provide additional insight into the audited entity's reporting.

Question 27
What would prevent such disclosures becoming boiler plated?

In our experience the recent enhancement to the audit report to include details of key audit matters has not resulted in boilerplate, and we see no reason why audit reports would not continue to be adequately tailored to the circumstances of each engagement in future.

Question 28
To what extent, if any, has producer-led audit (including standard setting) inhibited innovation and development for the benefit of users?

We have no evidence to suggest that innovation has been inhibited in the manner suggested.

For some time now standard setting has been the task of regulators comprising a wide range of interests, and has not solely been the domain of the audit profession. Despite recent concerns, we are of the opinion that the audit profession remains competitive which is of benefit to the users of financial information.

Question 29
What role should auditors play in determining whether the directors are complying with relevant laws and regulations, including with respect to matters of capital maintenance? Is it appropriate to distinguish between matters which may materially affect the financial statements and other matters?

It is not unreasonable to expect auditors to provide an opinion on whether an entity is compliant with laws and regulations that are of relevance to its financial reporting. Given our response to question 31 below, this would include matters of capital maintenance should the financial statements be required to include the disclosure of distributable reserves that is being proposed.

Question 30
Does a perceived inconsistency between company law and accounting standards as regards distributable reserves inhibit auditors from meeting public expectations? How might greater clarity be achieved?

The development of financial reporting standards, and in particular the rise in the use of fair values and estimation techniques that have relegated somewhat the need to exercise prudence, have led to greater disparity between company law and accounting standards as regards distributable reserves. Whether a profit has been realised or not is of little relevance in modern accounting frameworks, and in that regards company law has failed to keep up to date with recent developments. That said, the basic principle that companies should not over-distribute their profits remains sound.

We agree that the guidance published on distributable reserves by the professional bodies (TECH 02/17BL) is complex and can be difficult to interpret by qualified accountants, so greater clarity would be welcomed if auditors are to be able to meet public expectations in this area.

We believe that it would be beneficial for there to be a review as to whether the concept of distributable reserves remains appropriate given modern accounting practices, and whether any revision is required.

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

Given the importance that the users of the financial statements place upon having an understanding of the amount of reserves available for distribution, it is indeed surprising that there is no requirement for this to be disclosed and we would support this being rectified.

Through its inclusion in the financial statements, auditors would need to undertake procedures to ensure that distributable reserves have been correctly stated in all material respects, enhancing the role auditors play in ensuring that directors are complying with relevant laws and regulations related to capital maintenance.

Question 32
How do auditors discharge their obligations relating to whether the entity has kept adequate accounting records? Are the existing statutory requirements effective in setting the bar for auditors at a high enough level?

At a basic level audit work will always have at its heart consideration of whether a company's accounting system is adequately recording transactions accurately and on a timely basis.

The definition of accounting records as set out in the Companies Act 2006 is somewhat basic, and does not reflect the complexities of modern accounting. Consideration should be given to enhancing this, so that it is clear that accounting records comprise more than just details of receipts and payments etc, but also includes those working papers necessary to be able to demonstrate compliance with the reporting framework. In our experience if there are shortcomings with accounting information it is likely to be in areas such as determining impairment provisions, calculating fair values or assessing going concern, not the accounting records as defined in the Act.

Question 33
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?

We agree that it is vital that there is good communication between the auditor and the users of the financial statements. This is of particular relevance of Public Interest Entities where there will be considerable external interest in the financial statements. We feel that this would be better achieved by ensuring that there is adequate representation of all interested stakeholders within the Audit Committee, who of course already meet with the auditor on a regular basis. This would mean having place a process by which interested stakeholders such as investors and employees are able to be represented on the Audit Committee.

In addition we would like to see better use made of the Annual General Meeting as a means by which shareholders are able to challenge both management and the auditor on their conduct. This would require greater shareholder engagement than at present, and utilisation of the powers that they have already.

Question 34
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?

We feel that this would be beneficial, and could be achieved through the inclusion of an Audit Committee's Report as part of the Annual Report, which details the key matters that have been considered by the Audit Committee during the reporting period and their conclusions reached, including in respect of the annual report and the results of internal audit procedures undertaken. The wording of this report would require the agreement of both the Audit Committee and the Auditor.

Question 35
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?

It would appear to be beneficial for the audit report to include an update of the key audit matters of previous reporting periods, particularly if they are no longer considered to be of such importance.

Question 36
Do you believe that users' expectations of auditors' role in fraud detection are consistent with the requirements in UK law and auditing standards? If not, should auditors be given greater responsibility to detect material fraud?

We believe that this a key source of the expectation gap, that users misunderstand the auditor's responsibilities in respect of fraud. The perception would appear to be that it is one of the primary roles of the auditor to detect fraudulent activity, even when it may not have any material impact on the financial statements. This of course is not the case.

We believe that it should remain the responsibility of management to have in place a system of internal control designed to prevent and detect fraud. For PIEs this in part would be better achieved through effective internal audit, under the control of the Audit Committee.

The focus of the external auditor should continue to be the annual report and financial statements, and ensuring that they are free of material misstatement, however it may arise.

Consideration should be given to ensuring that the audit report gives clarity with regards to the auditor's responsibilities in respect of fraud, in perhaps a similar way that there is now improved reporting by auditors in respect of going concern.

Question 37
Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?

It seems odd to us that ISA 240 only considers revenue as an area that may be susceptible to material misstatement due to fraud, and not other areas of the financial statements. The standard could be improved by extending the presumption that all material aspects of the financial statements could be misstated due to fraudulent activity, and that the audit should be planned recognising this.

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

It should be possible to devise a test by which a reasonable person could assess whether an audit was appropriately planned to ensure that any material misstatement in the financial statements would be detected, and that there had been adequate consideration as to how fraudulent activity could result in such a misstatement.

Question 39
Should auditors be required to evaluate and report on an audited entity's systems to prevent and detect fraud?

Although of benefit, we would consider this to be a separate assurance service from the audit of the financial statements, and one that may require different skills and experience.

Question 40
Is the audit profession's willingness to embrace change constrained by their exposure to litigation?

At present we would say that this isn't the case, as litigation in respect of audit work remains rare. This may change if auditor liability is extended, as envisaged in Question 42.

We would agree with the statement that reputational damage arising from audit failure, and the potential regulatory action that may arise as a result, are more important drivers to promoting audit quality.

We believe that the audit profession is willing to embrace change. For example we have previously advocated for greater use of shared audit as a means for challenger and other firms to gain experience of the audit of Public Interest Entities in a way that enable them to manage their exposure.

Question 41
If there were a quantifiable limit on auditor liability, how might this lead to improvements in audit quality and/or effectiveness?

We do not see there being any link between audit quality and there being a limit on auditor liability. We believe that auditors will seek to perform their work to highest degree of quality possible regardless of any limitation of liability in place.

Exposure to risk is though an important issue for audit firms to consider, and can make them question whether it is appropriate to accept the level of risk that comes from providing audit services to the top end of the market. By having a limit on auditor liability this should encourage more firms to provide such services, improve competition and ultimately result in a more robust market for audit services.

Question 42
Should company law make auditors potentially liable, or otherwise accountable, to all stakeholders who reasonably rely on their audit work and their published auditors' report?

As desirable as this may sound, the vast range of potential stakeholders that may rely upon financial statements makes any extension of auditor liability difficult to achieve without seriously impact upon the number of firms that would be willing to continue providing audit services. The possibility of legal action being brought by investors, lenders, suppliers, staff, unions, tax authorities and any of the other stakeholders who may reasonably be expected to place some reliance on financial statements would make audit an unattractive profession to continue to operate in.

We feel that improvements in audit quality will be better achieved by having an effective regulator and disciplinary scheme in place rather than through any extension of auditor liability.

Question 43
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?

The improvements to the audit process proposed by this review will have implications for many audit firms, who are likely to reconsider their willingness to remain in the market for providing audit services to Public Interest Entities given the risk they present. Reform of auditor liability should be considered to ensure that there remains adequate competition in the market to help ensure audit quality remains high. As indicated in our response to Question 40 we believe that greater adoption of shared audit is one means by which this could be achieved.

We believe that this could be achieved through the introduction of a statutory limitation on auditor liability that did not require the approval of the audited entity's management or membership.

Additionally we believe that legislation should make clear to whom auditors owed a duty of care in respect of their statutory audit work.

Question 44
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?

We have no experience of the difficulty firms may be having in obtaining an appropriate level of professional indemnity insurance.

Audit firms will need to have in place risk management strategies, as the suggestion to extend the auditor's responsibilities to a wider body of users of the financial statements would have significant implications for the profession. This will include the need to have an appropriate level of insurance cover.

An inability to obtain insurance cover in respect of high-risk audit engagements of Public Interest Entities has the potential to restrict the number of audit firms in the marketplace, reducing competition and audit quality. For this reason the reform of auditor liability outlined in our response to Question 43 should be considered.

Question 45
How far is new technology actually used in audits today? Does the use of technology enable a higher level of assurance to be given?

A good auditor will always look for new and innovative ways of obtaining the audit evidence necessary to be able to form their opinion. It is important that the framework of auditing standards is sufficiently flexible to allow this to take place.

For the majority of audit firms data analytics is in its infancy, if it is being used at all. It is an exciting prospect, but at present there is still some uncertainty as to whether it is the most cost effective way to conduct an audit within the existing framework of standards, and some firms remain to be convinced. It is our opinion that if there is greater clarity from regulators on the role that data analytics can have, and the availability of software at an affordable price improves, then data analytics has the potential to significantly improve audit quality. Today though the majority of audit work will be performed in a more traditional way.

Question 46
In what way does new technology enable assurance to be given on a broader range of issues than is covered by the traditional audit?

Technology enables the faster, more efficient collection of audit evidence and has the ability to better help identify issues that may not be found using more traditional audit techniques. This is particularly true when assessing the effectiveness of the system of internal control, an area being considered by this review for extended reporting.

Through the use of technology the auditor is able to devote more time to critical audit matters, fully assess them and challenge where necessary, which should result in higher quality audits being undertaken.

Question 47
Are there aspects of current audit procedures or output that are no longer necessary or desirable?

It is difficult to highlight any specific audit procedures that are no longer necessary.

The auditing standards themselves are not actually over-prescriptive in setting mandatory procedures. They define a procedure to be followed when planning an audit engagement, and allow the auditor considerable flexibility in determining the procedures to be performed in order to meet the audit objectives that have been set, based upon the risk areas that have been identified. On any particular audit it is likely that there will procedures performed that may be considered unnecessary, but this is likely to be as a result of poor planning of that engagement not on the framework of auditing standards.

The example provided, questioning whether all notes in the financial statements need to audited, is for us unreasonable. The notes play a vital part of the financial statements, and without them the primary statements will not provide a full understanding of an entity's performance and financial position. It does highlight though how the ever increasing complexity and requirements of financial reporting have resulted in accounts becoming increasingly difficult to audit. Consideration should be given to the role financial reporting standards have had in resulting in the perceived problems with audit that persist today.

Question 48
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?

We agree that a zero-failure regime is not attainable, and that there needs to be greater acceptance that corporate failure may still arise even with the audit reforms that are envisaged.

The Review needs to ensure that its proposals are proportionate, that it acknowledges the differing expectations that exist and provides for a robust audit process without unduly burdening the smaller end of the market.

Question 49
Does today's audit provide value for money?

The profession needs to ensure that the audit process is considered by those that rely on financial reporting to be beneficial and of sufficient quality, in order to be able to be able to justify its cost. We believe that the audit profession is aware of this, and is prepared to accept the necessary reforms to ensure that audit remains a quality product that is valued by those that depend upon it.

Question 50
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?

It would appear that users are currently demanding a more rigorous audit process, and must accept that there will be costs in achieving this. Audit firms will seek to recover these costs through increased fees, and if this does not prove possible may reconsider their future involvement in market for audit services. It will be for the users to determine whether the enhanced reporting they seek is worth the additional cost that will be incurred.

Question 51
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?

We hope that shareholders read the audit report, and expect that sophisticated, institutional shareholders will do so. We fear though that the annual report as a whole has become an intimidating document to read for those shareholders who do not have any experience of financial reporting, and this will include the audit report.

The audit report has become significantly longer in recent years, and may well be seen as boilerplate by many users of the financial statements as a result. Consideration could be given to having more of the standard narrative accessed by way of a link to the FRC website to reduce the length of the report. This would help to ensure that the audit opinion is clearly identifiable in the report.

We have no experience of the role AI plays in reading and analysing audit reports.

Question 52
Would interaction between shareholders and auditors outside the AGM be practical and/or desirable?

For the majority of businesses we do not believe it would be desirable to increase the amount of interaction between the auditor and individual shareholders. For Public Interest Entities any concerns that shareholders have should be directed towards the Audit Committee, who in turn will have the opportunity to raise them with the auditor if they believe the concerns have any merit.

For SMEs there is often little differentiation between management and ownership, and there should already be in place adequate interaction between shareholders and the auditor.

We do appreciate though that for some large Public Interest Entities there is some merit for increased shareholder interaction, but believe that it is for each entity to determine its own requirements.

Question 53
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?

We believe that it would be impractical to involve shareholders in the planning of the audit. Through their representation on the Audit Committee, who do liaise with the auditor in setting the scope and other aspects of the audit process, the views of shareholders could be taken into account.

Question 54
What assurance do shareholders currently obtain other than from audit reports?

We expect that institutional investors will have their own financial analysts providing assessment and assurance in respect of an entity's financial performance. Private shareholders will receive assurance from the guidance received from their investment advisers.

In both cases the audited financial statements will form a major part of the source information used to provide assurance to shareholders.

Question 55
In what way would it be possible for auditors to report on the culture of the entity whose financial statements are being audited?

Auditors will often hold views on the cultural values of their clients, and this will often help to inform their risk assessment and audit approach. Reporting on the culture of an entity as part of the audit process though is a reform that we would have reservations about, in part due to the subjective nature of that assessment.

Question 56
How can auditors demonstrate that appropriate scepticism has been exercised in reaching the judgments underlying the audit report?

For Public Interest Entities the inclusion of Key Audit Matters within the audit report and how these have been approached provide the auditor with the opportunity to demonstrate the level of challenge and scepticism they have shown during the audit process.

Additionally for all audit work undertaken professional scepticism is demonstrated through the quality of the documentation of audit evidence obtained. The adequacy of audit evidence is considered by regulators when undertaking compliance reviews of audit work performed. If the users of financial statements have confidence that the regulators are performing their role adequately, then they can have confidence too that an appropriate level of scepticism is being exercised.

Question 57
Should the basis of individual auditor's remuneration be made available to shareholders?

Financial statements are already required to disclose the level of the auditor's remuneration, including remuneration receivable as a result of any non-audit services being provided. We would welcome any moves though which would provide greater transparency with respect to auditor remuneration payable by Public Interest Entities. For example we believe that greater information could be disclosed on the nature of any such non-audit services rather than just giving a broad heading such as 'Taxation services'.

Question 58
Do respondents view audit costs as generally too high, about right or insufficient?

We view audit costs as currently being about right, but would need to increase to reflect the additional work being envisaged by the reforms suggested in this review.

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

Please see our response to Question 57.

Question 60
Is the profitability of the audit function sufficient to sustain a high-quality audit industry?

An effective and high quality audit requires there to be an auditor willing to perform the task, and the economy as a whole requires there to be sufficient auditors to be able to undertake all engagements that are necessary. There needs to be a satisfactory level of financial incentive for auditors to perform this role if it can be expected to attract and retain the best talent, particularly when there is considerable demand for accountancy services in other areas.

There is already evidence to suggest that other disciplines provide more attractive financial rewards that audit, and any reform of the audit profession should bear this mind if it wants to retain a healthy, buoyant audit profession.