

Sir Donald Brydon

Brydon Review
Orchard 1
1st Floor
1 Victoria Street
London SW1H 0FT

11 June 2019

Dear Sir Donald

Independent Review into the Quality and Effectiveness of Audit

1. Introduction

Mazars, the international, integrated and independent organisation specialising in audit, accountancy and advisory services, welcomes the opportunity to contribute to your 'Call for Views'. Mazars operates as a truly internationally integrated partnership in 89 countries and territories, as of 1 January 2019, with correspondent offices in an additional 14 countries. Mazars draws upon the expertise of 23,000 women and men. In the UK Mazars currently has around 140 partners and over 1750 employees, and is ranked one of the top 10 accountancy firms nationally.

2. Characteristics which should underpin the auditing profession

The audit profession in the future needs to be defined by the following characteristics:

- a) Possessing Integrity and trusted
- b) Committed to high levels of expertise
- c) Innovative and responsive
- d) Improvement-orientated
- e) Proportionate
- f) Holistic
- g) Collaborative
- h) Respected and attractive as a profession

The application of these characteristics is discussed below where we set out our main proposals in relation to the future scope of audit and related matters. Our response to the detailed list of questions in the 'Call for Views' is set out in the Appendix attached to this letter.

We believe these should be at the heart of your review.

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3. A new qualification of Chartered Auditor should be established

To recognise the high level and distinctive skills required by auditors, a new qualification of Chartered Auditor should be created. This could either replace the title Registered Auditor or be a new title for a senior group of registered auditors. Consideration should be given to establishing a Society of Chartered Auditors under the auspices of the main professional bodies currently able to grant Registered Audit status. Such a body would enable auditors to speak with a single authoritative voice.

4. Independent body needed to ensure auditing remains responsive to the needs of its stakeholders

Your review is very helpfully considering a number of issues which are currently negatively impacting trust in the profession and its value to the users of audit. Given the crucial role of audit in ensuring confidence in information provided to our capital markets these need to be kept under review on an ongoing or, at least, regular basis. You have rightly pointed out that many of the issues currently being discussed were covered in the McFarlane Review of 1992 for the Auditing Practices Board but were not followed up. To stop this happening again, and this is always a risk with a service which is statutorily required to be purchased, we would suggest that following the conclusion of your review a body led by users of audit should be established to keep issues under review related to the scope of audit and to trust in auditors. The body should be demonstrably independent of the firms and the relevant professional bodies but would naturally involve auditors in its deliberations. It could form part of, or at least feed into the proposed new regulator, the Audit, Reporting and Governance Authority (ARGA).

In addition to looking at current improvements, there is also a need to consider longer term changes made possible by modern technology such as a system of continuous reporting and auditing, the demand for it, its merits, risks and how it might evolve but we do not believe this needs to be within the scope of your review.

5. The future of auditing cannot be considered separately from the future of reporting and an international perspective is also needed

The future of auditing cannot be looked at separately from the future of reporting as it is the financial statements which are subject to audit and if there is not confidence that they provide a true and fair picture of the performance and position of the business and, at least to some extent, its future prospects it is very unlikely that assurance on them will be highly regarded. A far more joined up approach to looking at reporting and auditing issues together is needed at both a UK and global level.

In undertaking the review, it will also be important to be conscious of which areas can be changed at a national level, and so directly within the scope of the review, and which will require international changes such as matters related to International Standards of Auditing (ISAs), discussed further below, in respect of which the UK has influence but not ultimate jurisdiction. It will also be worthwhile considering best practice from other countries, e.g. the 'duty of alert' in France as recommended in the report of the Kingman Review.

6. Assurance needs to be extended beyond the financial statements in a number of areas

For most large businesses the vast majority of their value lies in their intangibles whether it be their brands, customer relationships, other forms of intellectual property and their corporate culture and where these are internally generated they are generally very inadequately represented in the financial statements and often only fairly patchily so in narrative reporting. The reporting of intangibles clearly needs to be improved and enhanced narrative reporting is likely to play a key role in achieving the necessary changes.

Requiring assurance generally on narrative reporting that had been strengthened or on certain specific parts of it could provide users of corporate reports with more and higher quality information on the value drivers of the business. If looking at providing assurance in specific areas, rather than narrative reporting as a whole, those covered might include disclosures related to corporate culture, intangibles, climate change and sustainability more generally as well as the principal KPIs used in the business including alternative performance measures.

There would also be merit in improving the detail provided in viability statements and ensuring the period covered by them is appropriate to the business. Requiring assurance on them would help achieve these goals.

7. Thorough review of the evidence needed before a move to a UK version of Sarbanes-Oxley

It would be easy for us on grounds of self-interest to support a UK version of the Sarbanes Oxley Act, an idea which the Kingman Review suggested merited serious consideration.

We believe, however, that the public interest requires a thorough assessment of the evidence of the costs compared to the benefits of this legislation which was introduced in the immediate wake of the Enron and WorldCom crises. It did not, for example, stop the US being significantly impacted by the Global Financial Crisis in 2008 and our understanding is that research is inconclusive on the net benefits of introducing the legislation with the most doubt being over the relative merits of the need for management's statements on financial controls to be externally audited.

In principle, we see merit in management and the board being expected to confirm that in their opinion the necessary internal controls are in place and working effectively and they may wish commission their internal or external auditors to make appropriate checks this before making their statement in the annual report.

8. Uncertainty related to capital maintenance requirements should be resolved

There has been much controversy in this area in recent times. We recognise the complexities involved but consider the issue should be resolved. If the current system is to be retained, the level of distributable reserves should be disclosed and subject to audit with a clear reminder that a distribution may only be made if there are sufficient reserves. We would also encourage consideration of whether there are alternative systems which might better address the underlying issue of when in the interests of other stakeholders limits should be placed on dividend distributions and possibly also share buy backs.

9. Detection of fraud

We believe the auditor's responsibilities in relation to the detection of fraud are reasonably clearly set out. It would be helpful to have a review on how they are being fulfilled in practice and whether more could be done. Any extension of responsibilities would probably best be left to discussions with investors, in particular, on whether they thought they should be extended and, if so, whether they would be willing to bear the likely extra cost. An alternative approach would be for internal auditors to increase surveillance in this area.

10. The role of audit in reducing company failure

Whilst recognising that it is the role of directors to run their businesses and that no system of auditing can be expected to eliminate corporate failure, we do believe an effective system of auditing will reduce

failures by providing early warning systems and 'red flags' which, if acted upon, will allow actions to be taken to return the business to good health. In addition, auditors can add value through a thoughtful management letter highlighting observations made whilst undertaking the audit which will not necessarily form part of the public reporting but will enable improvements to be made which will strengthen the business.

11. Proportionality needed with regards to liability and regulation

We continue to support a move to a system of proportionate liability for statutory audit as we believe it is the fairest system with auditors fully liable for their own mistakes but not for those of others. It may also increase the number of challenger firms willing to enter the FT350 audit market. Leaving the current system of unlimited joint and several liability in place, as investors have not been willing to agree a limitation by contract in the case of listed companies, requires proper justification when there is concern about the possibility of one of the Big 4 firms leaving the large listed audit market. A fairer liability system would also make auditors readier to accept an increase in the scope of their responsibilities but if the current system remains unchanged the best way forward would be for any additional responsibilities to be outside the scope of the current statutory audit and for liability to be able to be limited through the letter of engagement.

We also believe it is essential that the system of regulation be proportionate as regards the relative focus given to reviewing the audits, and in future also the audit committees, of Public Interest Entities of different sizes with the emphasis being on the top end of the FTSE350 where the systemic risk is greatest. Proportionality is also needed with respect to the treatment of audit firms of different sizes which are subject to sanctions.

The new regulator, ARGA, should foster an improvement culture and encourage co-operation between all key stakeholders in the audit market- investors, audit committees, firms of different sizes, the regulator and government. The active involvement of all key stakeholders in fulfilling their respective roles in the audit market is essential for the restoration of trust in auditors and if audit is to meet users' needs and expectations.

12. Major review of audit standards and regulatory culture needed

Linked to the need for proportionality in regulation, there is a need for a thorough review of auditing standards as they have tended to become very rule-based. We believe a move towards a system which places the primary emphasis on the application of principles, accepting there may be a need for some specific requirements, which would be similar to our approach in the UK on corporate governance would be beneficial. The current 'rule book' approach to audit with its focus on compliance with checklists and equating doing a good audit with the checklists being completed rather than on achieving the right outcome is fostering the 'commoditisation' of the audit at the expense of providing additional value to the users of the audit report.

The regulatory culture also needs to be reviewed. Some necessary improvements have been made in documentation in recent years and a new primary focus is now needed on the overall determinants of audit quality. A distinction should also be drawn between where genuine error occurs and where there is reckless behaviour or deliberate misdeeds.

13. Maintaining the attractiveness of the audit profession to new entrants

Given the expertise needed to audit, for example, complex global organisations and the inherently high degree of judgement required in arriving at the audit opinion, it is essential that the audit profession continues to attract leading young people of each generation and to retain the experience, expertise and judgement of current senior auditors. It is partly for this reason that we have suggested that their special skills be recognised by the higher qualification of Chartered Auditor but it is also vital that they not be deterred from specialising in auditing by a feeling that there is a regulatory system that is not fair and proportionate and that remuneration levels are appropriate.

14. Brydon Review should not hold up market reform

Whilst we regard it as important that the various parts of the audit reform package (CMA, Kingman and your review) are seen as an interlinked package, we are equally clear that the other parts of the package do not need to be held up pending finalisation of your report as, for example, changes in the scope of audit would be perfectly compatible with a reformed market structure in which there was joint audit for most FTSE350 companies, as recommended by the CMA following their thorough review. Whilst you have indicated that joint audit is outside the scope of your review we would point out that the extra amount of review involved can reasonably be expected to enhance the likelihood that a high-quality audit will be undertaken. A system of joint audit across the FTSE350 would also contribute other factors such as the sharing of best practice and of benchmarks related to the audit.

15. Further discussion

If you would find it helpful to discuss any aspect of this response, please contact David Herbinet, Global Head of Auditing and Assurance or Bob Neate, UK Head of Audit.

Yours sincerely

Mazars LLP

CHAPTER 1 – DEFINITIONS OF AUDIT AND ITS USERS

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

Audit should be conducted for the benefit of all stakeholders with a legitimate interest in the performance, position and prospects of the business.

It has traditionally been considered that financial statements prepared to meet the needs of shareholders, the providers of the ultimate risk capital, should generally also meet the needs of other stakeholders. This is probably generally a reasonable approach though there may be circumstances, such as when a business is in financial trouble, when it would be important specifically to consider the interests of other stakeholders, such as employees and providers of loan finance, separately from those of shareholders.

We consider the question of for whose benefit audit should be conducted should be clearly separated from that relating to whom the auditor owes a duty of care with the latter relating to audit liability.

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

The focus of assurance should be on the performance, position and prospects of the business which extends much more broadly than that currently covered by the financial statements.

The audit is currently designed to enhance the confidence of intended users in the financial statements and, to a limited extent, in the case of listed companies in certain other parts of the annual report as well.

As a general matter, whether the above will enhance the confidence of the users in the entity will depend on whether it is considered that the financial statements fairly reflect the performance, position and prospects of the business. We believe that due to challenges in the reporting model this often will not be the case at present, e.g. as a result of inadequate information relating to the intangibles in many businesses and the need for fuller disclosures concerning an entity's prospects and future viability. This is a significant cause of the current 'expectation' gap.

Going forward, we would propose that auditing be extended to cover all or significant parts of a strengthened system of narrative reporting and to the extent this provides higher quality information on the performance, position and prospects of the business it should increase confidence both in the relevant information published by the business and in the business itself.

Even if it were considered that the audited information in the financial statements, and if applicable also elsewhere in the annual report, fairly reflected the position, performance and prospects of the business, whether confidence in the financial statements and other

audited information translates into confidence in the business will naturally depend on the picture portrayed by the audited statements.

Q3: Should UK law be amended to provide greater clarity regarding the purpose of an audit, and for whom it is conducted? If so, in what way?

In theory 'yes' as regards for whom an audit is conducted, though in practice we do not consider this is a principal cause relating to the lack of trust in audit opinions.

As paragraph 21 of the 'Call for Views' highlights, the purpose of an audit is already clearly set out in auditing standards.

If legislation were to set out for whom audits are undertaken, e.g. in the manner suggested in our response to Question 1, it would also be important to indicate to whom auditors owe a duty of care that may give rise to legal liability. We believe liability should not extend beyond the shareholders but were it to do so it should be clear to which other groups the auditors owed a duty of care and to what extent they would be entitled to compensation or damages were they to demonstrate negligence by the auditors, as regards protecting their interests, in relevant circumstances.

CHAPTER 2 – THE 'EXPECTATION GAP'

Q4: Do respondents consider there is an expectation gap?

There definitely appears to be an 'expectation gap' where expectations are not matched fully by the corresponding statutory and regulatory framework and these would particularly seem to exist with regards to items (a) and (b) in paragraph 24 of the 'Call for Views' namely in relation to:

- the audit providing assurance over the sustainability of an enterprise or its business model; and
- the auditor having actively sought out any evidence of fraud

In some areas there may be a mixture, on occasion, of 'expectation' and 'delivery' gaps, the latter as discussed in Q6. For example, in relation to fraud, the auditor should plan their work so as to be able to provide reasonable assurance that the financial statements are free from material misstatement arising from fraud but there may be expectations that the auditors will actively seek out any fraud.

Similarly, as regards 'going concern', the auditor does have certain responsibilities and a review of current auditing practice would be helpful but the requirements probably do not extend as far as some would expect.

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

We agree with the characterisation of the expectation gap as the 'perceived difference between what users of financial statements and the public expect from an audit, and what an audit is required to deliver under existing UK law and auditing standards.' This

expectation gap is particularly evident in relation to a number of items considered elsewhere in the 'Call for Views'.

Q6 below discusses the characterisation of a 'delivery' gap.

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

There would appear to be a 'delivery' or 'quality' gap between auditors' existing responsibilities in law and auditing standards and how those responsibilities are currently met, or at least have been until recently, and this would particularly seem to relate to work undertaken in relation to capital maintenance in connection with the payment of dividends. Closing the gap in this area, is however, unlikely to have much impact on the overall 'expectation' gap

A 'delivery' gap may also exist, in certain instances at least, alongside an 'expectation' gap in relation to fraud and going concern.

CHAPTER 3 – AUDIT AND WIDER ASSURANCE

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

We believe the role of the statutory auditor should extend beyond the financial statements and include the narrative report, or appropriate parts of it, such as those areas relating to additional or supplementary information on the performance, position and prospects of the business including, for instance, information relating to the viability statement and to intangibles and other forms of capital, the latter as discussed by the International Integrated Financial Reporting Council.

Given the challenges presented by the current approach in practice of unlimited joint and several liability with regards to the audit of the financial statements, at least of listed companies, we believe that either a new fair approach to liability is needed or any new areas of required assurance should be treated as distinct from the current statutory audit though given the linkages between them we would expect them to be provided by the same auditor.

We consider, however, that the current approach to liability is not fair in so far as unlimited joint and several liability is unduly burdensome on the auditors and should be replaced by a system of proportionate liability.

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?

The level of assurance that an audit provides should be the same in the sense that it should ensure that the opinion is 'true and fair' in all material respects but there will be inherently greater degrees of subjectivity in the financial statements in some sectors than others, e.g.,

where a substantial proportion of revenue is based on the allocated profit arising from estimating the degree of completion of long-term contracts, as compared to when it arises from selling standard items at a given price. It will also be important for there to be appropriate disclosure of the different circumstances in the notes to the accounts in terms of presenting the risks and key judgements made by the directors.

More generally, there will be an inherently higher degree of subjectivity on future oriented matters than past transactions.

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

This is an important area for consideration by the Brydon Review. The boundaries are clear in the sense that the internal auditor reports to the audit committee whereas the external auditor reports to the shareholders and the primary role of internal audit is to assess the system of internal control whereas that of external audit is to express an opinion on the financial statements which are produced from that system. That said, some of the work undertaken by internal audit may provide relevant audit evidence for the external auditor (and vice versa) and thus there is clearly potential overlap in the work of the internal and external auditors. Accordingly, there is merit in the internal and external auditors liaising effectively in planning and undertaking their work with particular regard to adopting an informed approach to assessing risk in the business.

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

We think they should be able to use evidence obtained from the work of internal audit, just as they use that from a variety of other internal and external audit sources, but only if they are satisfied as to the independence of the internal audit function from management and the quality of its work.

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

We believe it is right that a majority of the voting rights in audit firms should be owned by those eligible to be auditors in order to protect the independence of the firm. We do not believe that this should be a barrier to innovation as evidenced by the substantial investments in technology made by the larger auditing firms in recent years and it similarly should not stop appropriate external investment in audit firms where this is desired.

CHAPTER 4 – THE SCOPE AND PURPOSE OF AUDIT

Q12: Should directors make a more explicit statement in respect of risk management and internal controls? If so, should such a statement be subject to audit?

We believe there would be merit in the board of directors, following enquiries of management and, if appropriate the involvement of internal audit, making a specific

statement in terms of risk management and internal controls indicating, if applicable, that they consider there is an effective system of risk management and internal controls in place and that it is working effectively.

It will be important, however, to consider the likely costs of subjecting it to external audit as compared to the expected benefits in making a decision on whether this should happen. Investors' views will be very important in such a consultation as audit firms and those representing them will have an inherent conflict of interest given the potential fees that will arise from such a change. Reference should be made to independent research on the experience in the United States in implementing the Sarbanes-Oxley Act. There was some concern that the related audit costs were high. Ensuring costs relative to the benefits are reasonable is important as it can have a significant bearing on the attractiveness of being a listed company which is especially important in the UK where there are a substantial number of smaller listed companies. At the time of the introduction of the Sarbanes Oxley Act in the US, some companies gave up secondary listings there. Moreover, as the global financial crisis indicated, the preventative impact of the act in the US was clearly limited.

Given their responsibility for, and ability to override, internal controls, the vital need is for management to be fully aware of their responsibilities and for these to be overseen by the audit committee and board with sufficiently strong sanctions where controls are not properly maintained.

The crucial point in relation to ensuring effective risk management and internal controls is that this is primarily driven by the culture in the organisation whereas Sarbanes-Oxley focuses to a large extent on transactional testing which will often not provide the early warning signs of problems in how the business is being run.

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

As paragraph 49 of the 'Call for Views' indicates, the auditors' responsibilities in relation to internal control are currently limited.

ISA (UK) 260 sets out issues which auditors are required to report to those companies reporting on their application of the UK Corporate Governance Code. Based on the audit procedures performed, the auditor should express their views about: 'The effectiveness of the entity's system of internal control relevant to risks that may affect financial reporting' and 'Other risks arising from the entity's business model and the effectiveness of related internal controls to the extent, if any, the auditor has obtained an understanding of these issues'.

It will be seen that these controls are currently limited to those that may affect financial reporting and, in particular, to issues which may have come to light.

We have discussed our views on extending the auditor's responsibility to expressing a view on the effectiveness of internal control in our response to the previous question.

Q14: Auditors are currently required to report to audit committees their views on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?

Paragraph 49 of the 'Call for Views' makes clear auditors only have to report issues relating to the effectiveness of controls which come to their attention. So long as users understand the nature of the auditor's responsibility, disclosing their findings to users could be helpful though the risk of disclosing information which may be harmful to the running of the company might need to be considered.

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

We would support the proposed changes to the FRC consultation of 4 March 2019 to ISA (UK) 570 to ensure auditors challenge robustly management's assessment of going concern, to thoroughly test the adequacy of the supporting evidence, that they properly evaluate the risk of management bias and make full use of the viability statement.

We also support a new reporting requirement for the auditor to provide a conclusion on whether management's assessment is appropriate and to set out the work they have undertaken in assessing it.

We also support a stand back requirement to consider all the evidence obtained whether corroborative, or contradictory, when the auditor draws their conclusions on going concern.

Q16: Should there be greater transparency regarding identified "events or conditions that may cast significant doubt on the entity's ability to continue as a going concern"?

Yes, we would greater transparency in some instances regarding identified 'events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. These should primarily be disclosed in the strategic report and in the notes to the accounts within the key judgments section.

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

We believe there is scope to improve the viability statement both with regards to the period covered by them which have tended to become standardised around three years and the quality of disclosure around issues considered in assessing future viability. In terms of the period covered it should have proper regard to the business model and the normal duration/lifespan of contracts and items requiring significant capital expenditure and of the products of the business. We would expect such a change to significantly increase the normal period covered in certain long-term capital intensive industries.

Q18: Should such a statement be subject to assurance?

Yes. We believe this would increase confidence in the information published by the board on the performance, position and prospects of the business and given its importance to users should be subject to assurance.

Further thought will be needed, however, on the nature of the assurance to be provided given the inherent uncertainty and subjectivity and this will increase as the timespan lengthens.

Q19: Who might be capable of giving such assurance?

We believe the assurance would best, and most efficiently, be provided by the auditor of the financial statements. If desired, however, it could be provided by other statutory auditors who are eligible to be company auditors. In order to do this it will be important for the auditors to ensure they have, as would be current good practice, a high level of expertise in the sector and of likely future developments in it which may include the possible entry of disruptors with radically different business models.

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

We believe there would be benefits in a more forward-looking audit. This would lead to the information on which assurance is provided better meeting the needs of the users of financial statements and corporate reporting more widely, given that information on expected future performance and position is of significant interest to them.

In saying the above, we would emphasise that preparers and auditors of financial statement already need to have significant regard to forward-looking information and far more so than is often realised. It has to be taken into account, for example, in assessing going concern, in relation to assessing the profit earned to date on long-term contracts, in assessing the recoverability of debtors and in considering whether the carrying value of assets should be subject to an impairment charge.

Notwithstanding the above, the benefits of an audit that was forward-looking to an even greater extent would be that the overall quality of information published on the future prospects of the business would be enhanced. Given, however, that it is forward-looking it is inherently more subjective than historical information relating to transactions or events that have taken place and hence the nature of assurance that can be provided will be different, i.e. whereas for historical information the auditor can offer an opinion on whether it reflects a true and fair picture of what has happened, for future orientated- information they are necessarily restricted to saying whether the assumptions on which the future projections are based appear suitable having regard to the likely internal situation of the company and the external environment for the period covered by any forecasts.

Clearly one of the risks of providing assurance on likely future outcomes, relating to performance or position in terms of liquidity and/or viability is that users may assume the assurance provided is greater than is possible in the case of forecasts. Moreover, the greater the subjectivity of the information subject to assurance, the greater the trust needed in independence and skills of the auditor if it is to be of value to users.

Another related issue to be considered is the provision of assurance on selected historical information on a more frequent basis than at present such that the time lag between the period to which the information relates and its being published in an assured form is less than generally is presently the case with regards to annual audited financial statements.

This issue which is related to the wider theme of ‘continuous’ or ‘live’ auditing’ is not really covered in the ‘Call for Views’ and is a very important one for the future of the profession, both as regards reporting and auditing, as moves in this direction are far more viable now given advances in technology. It would, however, have substantial implications not least linked to the trade-off between relevance and reliability: information published more quickly is generally more relevant to users but the inherently greater limitations on the time available to audit it may reduce its reliability.

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?

Audit or assurance of appropriate financial information outside the annual financial statements would enhance its credibility and therefore would be of benefit to users. This is subject to the information on which the assurance is provided being regarded as important to them. The assurance also needs to be considered to be fully independent and based on the necessary subject matter knowledge as well as knowledge of effective auditing techniques.

On KPIs, the auditor could provide assurance both on the reliability of the figures provided outside the financial statements and comment on their appropriateness including whether the figures provided are similar to those used by industry competitors to measure performance and calculated in a similar way.

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

We regard this question as being one of the most important ones in the ‘Call for Views’.

In deciding areas for further assurance, the primary driver should be the views of investors and other key stakeholders on the areas in which they would find further assurance helpful and to a significant extent this will be influenced by the degree of trust they have in the auditor’s independence and expertise in given areas.

Subject to the above, areas for primary consideration would include:

- the viability statement and determination of going concern
- the sustainability of the business model
- disclosures related to the future sustainability of the enterprise in social and environmental terms, especially with regard to climate change risk, as well as financial terms
- information on the desired and actual cultures in the business and how any gaps between them are being addressed

- identified key metrics, including alternative performance measures linked to financial statement disclosures and those related to key intangibles as well as to climate change and workforce issues
- information related to data privacy
- as an alternative to the above, a requirement for the whole of the annual report to be subject to assurance including certain additional information in stand-alone sustainability or in similar reports where core data in relevant areas are not contained in the annual report

CHAPTER 5 – AUDIT PRODUCT AND QUALITY

Q23: Do respondents agree that the value and quality of the audit product should be considered separately from the effectiveness of the audit process?

The quality of the audit product and the effectiveness of the audit process are clearly inextricably interlinked and should be considered together by both auditors and regulators. Whilst we understand joint audit is outside the scope of the Brydon Review, we consider the joint audit process, which involves a greater level of review and, normally, two firms making judgements on the complex and subjective areas of an audit, leads to a greater guarantee of a high-quality audit.

The effectiveness of the audit process enables the appropriate audit opinion to be given but cannot of itself ensure this as the quality of the audit opinion and related reporting is also dependent on the independence of the auditor, their skills and expertise and the quality of judgements made. A process can be followed without the best judgments being made on the figures and explanations in the financial statements.

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

Our understanding is that during a recent Thematic Review on Audit Quality firms expressed the view that whilst they felt the quality of documentation had improved significantly in recent years they were not as convinced that audit quality had improved to the same extent. This could be because less improvement was needed in audit quality and the primary issue was that better documentation was needed to support the decisions reached. The alternative reason could be that the additional emphasis on reviewing the quality of the file, because this was where the regulator has placed emphasis, has been to some extent at the expense of additional time being spent on, or consideration given to, issues of judgement related to the performance, position or prospects of the business under review. This challenge has been exacerbated by recent changes in the audit disciplinary process where failure to follow procedures of itself may give rise to penalties regardless of the cause of the issue arising and/or its impact on the appropriateness of the audit opinion.

We also understand that cases have come to light where there are now considered to be substantial issues related to the quality of the audit but where the FRC, as regulator, had not picked these up in its review of the audit file.

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

We are not convinced that a switch from the current system of reporting would enhance users' understanding of the view of the auditors on the financial statements and we are also not sure it is appropriate to refer to the current system as one of binary opinions.

The current system provides for a completely clean opinion, a 'clean' opinion with an emphasis of matter and discussion of Key Audit Matters in the case of PIEs, a 'subject to' or 'except for' opinion highlighting a material uncertainty or particular area of disagreement with the board's view, an adverse opinion that the accounts do not give a true and fair view and a disclaimer where they say the auditor cannot form a view. We believe this approach accords with the desire by users to know simply whether or not, having regard to all the relevant factors, the financial statements show a true and fair view of the performance, position and cash flows of the business in the period under review and at the period end, as appropriate.

The idea of 'graduated findings' as set out in the 'Call for Views' may make it harder for the users to understand the auditor's overall view of the financial statements. It seems reasonable, indeed necessary, for the auditor to form their overall view on the accounts as a whole and in doing so to decide whether, for example, the board's forecasts on future performance, say as regards possible impairments, are within acceptable bounds from the auditor's perspective whilst it being helpful for them to provide additional information such as the perceived degree of optimism, there should be no doubt, however, as to whether the auditor has accepted that the financial statements resulting from their application and from making a variety of other judgements give a true and fair view.

It is, of course, a different question as to whether the current range of opinions is being properly applied and care needs to be taken that a discussion in the extended auditor's report is not seen as a substitute for giving an opinion other than a completely clean one.

We believe there are opportunities to provide more informative disclosures on Key Audit Matters in respect of PIE audits.

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

It would be helpful to have a discussion with investors and other stakeholders, as appropriate, on whether they considered public reporting by auditors was sufficiently informative and what further information would be of most value to them along with their views on examples of current good practice and circumstances in which they feel the auditor could more helpfully provide/have provided additional information. In undertaking the discussion it will need to be recognised that in certain instances such information will come into the 'unknown unknown' category from their viewpoint though with regards to a

certain recent high profile corporate collapse it appears some institutional investors were sufficiently concerned at what was happening to have divested themselves of their shares in the company.

Q27. What would prevent such disclosures becoming boiler plated?

The dangers are of disclosures becoming 'boilerplate' in that concerns are only expressed in very vague terms or that a 'kitchen sink' approach is adopted where auditors set out multiple issues which may indicate risk as to the reliability of their opinion and may further reduce trust in auditing and/or be used subsequently if a problem does arise by auditors to say they had flagged an issue even though they had given a completely clean opinion.

Effective oversight by the regulator on both the opinion and information surrounding it is an important mechanism in preventing disclosures becoming boilerplate. Investors also have an important role to play and should both recognise high quality disclosures, as they currently do through an awards scheme run by the Investment Association, and challenge those that they consider inadequate. They should also use the quality of disclosures as one of the factors they take into account when deciding whether to endorse the board's preferred choice of auditor.

Moves to a fair system of liability would also be expected to make auditors less risk averse in making disclosures.

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

The issue is not so much 'producer-led' auditing as such rather it relates to the dominant players being allowed to have too dominant a position in standard-setting and various other areas relative to challenger firms leading to a limited range of views being discussed.

In technical areas such as auditing, it is important that standard-setters and others have good knowledge of the process whilst ensuring users' views are to the fore when decisions are taken. This, however, requires users such as institutional investors to be willing to be actively involved in auditing matters and to devote the necessary time to them, an area where there is scope for significant development.

CHAPTER 6 – LEGAL RESPONSIBILITIES

Q29. What role should auditors play in determining whether the directors are complying with relevant laws and regulations, including with respect to matters of capital maintenance? Is it appropriate to distinguish between matters which may materially affect the financial statements and other matters?

Given the wide variety of legislation applicable to directors and companies, it needs to be clear with which laws auditors are responsible for checking compliance. It would seem reasonable to focus on those which may materially affect the financial statements. In doing

so it is important, however, to bear in mind that the duty of auditors is to consider materiality from the point of view of the users having regard to the fact that different levels of materiality apply, for example, to directors' remuneration than generally for other issues. Moreover, whilst, for example, auditors may not normally focus on a company's compliance with health and safety legislation, important though the issue is, it would be expected to do so if it becomes aware a substantial breach appears to have occurred leading potentially to significant remedial work and possibly heavy fines or removal of licences and permissions.

As the current purpose of the audit is to offer an opinion on financial statements prepared in respect of a given period, it seems appropriate to distinguish between matters which may affect the financial statements and other matters. As discussed in response to Question 36, however, this does not mean that limited additional responsibilities should not be added but that this should only happen after careful consideration on a case-by-case basis.

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?

This has been an area of longstanding difference of view primarily between the regulator and some investors. The regulator, as opposed to the ICAEW, being responsible in future for the definition of realised profits and clear guidance being offered by them to directors and auditors on their respective legal responsibilities, and expected disclosures, should be helpful in moving forward on this issue.

In practice, the issue is undoubtedly challenging given the complexities of some group structures, transfers between companies in the group, the difference between recognised profits in the financial statements and realised profits under company law and the fact that it is a cumulative calculation.

We would also encourage consideration of whether there are alternative systems which might better address the underlying issue of when in the interests of other stakeholders limits should be placed on dividend distributions and possibly also share buy backs.

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

Yes, if the present system is to be retained, we believe this would be helpful in resolving any doubt on the extent of distributable reserves. A current challenge is that many boards of directors are not keen to make the disclosures whilst this is a significant area of concern for some investors. Having clarity on what should be disclosed will be helpful.

Q32. How do auditors discharge their obligations relating to whether the entity has kept adequate accounting records? Are the existing statutory requirements effective in setting the bar for auditors at a high enough level?

The existing obligation on the auditors to consider whether the entity has kept adequate accounting records is clear. It may be helpful for the regulator to consider whether they

have been paying sufficient attention to this area though this links back to longstanding views of the regulator on the capital maintenance issue.

This is an area which might have benefited from more attention by the regulator in recent years.

CHAPTER 7 – THE COMMUNICATION OF AUDIT FINDINGS

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

Yes, most definitely there should be increased dialogue between the auditors and the shareholders, to whom they currently report, or the shareholders and agreed other stakeholders if those to whom they owe a duty of care is extended.

If it continues to be the shareholders, then the AGM is the obvious arena for a wider dialogue. If the stakeholder group to whom the auditor is responsible is widened then holding an annual assurance meeting could be an appropriate way forward. It would, however, be important to consider whether such a meeting should just be to discuss assurance or whether it should have a broader focus and discuss issues related to the performance and governance of the business generally as well as assurance matters. It would also be important to consider how such a meeting dovetail effectively with the AGM and whether it would best would be in addition to or instead of it.

Whichever approach is adopted, it will remain essential to maintain equality among shareholders and ensure that the timing of communication of information by the auditor is consistent with applicable rules on trading for listed companies so as not to create arbitrage in the trading of shares.

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

We agree, in principle, to the idea of more of the communications between the auditor and the audit committee and resulting judgments being made transparent to users of the financial statements but it needs to be borne in mind that the act of making the information public could change the nature of the disclosures made with the risk that they would become less insightful. It will also be important to consider how the information that should be provided in the report of the audit committee should dovetail with disclosures expected to be made by the auditors so as to avoid undue repetition and potential confusion from the same issue being expressed in slightly different ways.

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

In principle yes though care will be needed to ensure that any updating disclosures remain relevant a year on and that they do not simply repeat disclosures elsewhere in the annual report.

CHAPTER 8 – FRAUD

Q36. Do you believe that users' expectations of auditors' role in fraud detection are consistent with the requirements in UK law and auditing standards? If not, should auditors be given greater responsibility to detect material fraud?

The FRC's Statement on the auditor's responsibilities, as set out in the 'Call for Views' seems clear and reasonable at least as regards the auditor's role in relation to the financial statements:

'The auditor's objectives are to obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. The risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control'.

This leaves two possible issues: whether levels of materiality are in line with users' expectations and, even if so, whether users consider frauds below this level should be brought to light as it will be fairly high in absolute terms for the largest companies. This is an issue for practical investigation and if users' expectations are not being met it would be worth considering whether auditors' should be given specific additional responsibilities in relation to identifying frauds of a certain size, probably expressed in terms relative to the company's size however defined, and whether this could be justified on a cost/benefit basis bearing in mind that as well as additional frauds being identified another benefit would be likely to be enhanced confidence in audit. Clearly care would be needed as to whom the reporting should report, most likely the audit committee, as to report publicly may damage the business or not be possible for legal reasons, raising the risk that even if more frauds were detected by auditors with new requirements in place, the public perception may not change as much as it should due to limited reporting.

As part of the consideration of the issue covered by this question, it would be useful for a review to be undertaken to determine whether auditors are generally felt to be doing sufficient work to fulfil their current responsibilities in relation to fraud. These include an obligation under company law to report irregularities, including fraud, to the regulator and it would be helpful, as part of the proposed study, to obtain information from the regulator as to how often this has been done. Although the meaning of the phrase "reporting of irregularities" possibly deserves clarification, the processes and requirements are there and what seems to be missing is their application in a consistent way. On the other hand, it would be unlikely to make sense for auditors to be expected to look for additional frauds that would not be deemed significant, however defined. We would also refer you to a

publication by Accountancy Europe on 'Auditor's role in fighting financial crime: Standing up to fraud, corruption and money laundering' which we believe will be useful in considering auditing issues related to fraud.

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

As discussed in paragraph 105 of the 'Call for Views' with regards to the 2013 thematic review of fraud, the issue does not seem so much to be with the standards as with how auditors, in general, are applying them and this may be a helpful area for further follow up.

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

This would seem to probably be more of an area for lawyers but, as discussed above, the standards seem reasonable and it may primarily be a matter of focusing on their application in practice.

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

Our response to this question is linked to that to Question 36 above. If it were deemed helpful to give auditors specific responsibilities in relation to the detection of fraud, in addition to those related to preventing a material misstatement in the financial statements, then this would be a natural area to consider.

CHAPTER 9 – AUDITOR LIABILITY

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

Yes. There clearly is a relationship between the audit profession's exposure to litigation and its willingness to embrace change voluntarily, as opposed to there being a requirement for auditors to do so by virtue of regulation, legislation or other requirement.

The present liability regime has led to a standardisation of approach in order to protect against litigation. We believe auditing standards should start from a principles based approach in line with that applicable to directors as set out in the UK Corporate Governance Code. This would allow innovation in terms of how to apply the principles whilst accepting that there may be some fixed requirements similar to provisions in the governance code.

We believe the market structure has also significantly inhibited change. Where there is a dominant oligopoly as there has been in the listed audit market for decades it is likely that innovation will be less than in an industry where there is a more competitive market as is demonstrated in a number of other industries. Often, it is new entrants in previously highly concentrated markets who lead on innovation but the barriers to entry for challenger firms has meant this has not been possible to date in the listed audit market.

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

We believe a strong case can be made on grounds of fairness for a move from the current system of unlimited liability on a joint and several basis to one based on proportionate liability such that auditors are responsible for the damage resulting from their own mistakes but not those of others. This remains our preferred way forward as we believe it to be the one that best meets the public interest.

Were a quantifiable limit to be introduced, this would have the merit of providing greater certainty on the maximum possible liability on a given audit and therefore may increase the attractiveness of the market to more challenger firms than would otherwise be the case.

On grounds of competition, however, any such quantifiable limit should be expressed as a function of, say, audit fees rather than an absolute cap as the latter would tend to favour the largest firms in an unequal way with little benefit to users.

Moreover, we are not persuaded that unlimited liability enhances the emphasis on audit quality: the appropriate audit firm culture and effective regulation are far more likely to be influential determinants of audit quality.

It would also help for there to be a better understanding of how firms insure against liability as this has a strong impact on how firms manage their professional risk.

In addition, to there being a proportionate approach to auditor liability, we also believe it is fundamentally important that the regulator adopts a proportionate approach to the way they undertake their duties especially in relation to the issuing of sanctions to firms of different sizes.

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?

We consider the responsibility of auditors under company law should be consistent with that of directors under s172 of the Companies Act, 2006 given that the directors have the responsibility for preparing financial statements that show a 'true and fair' view with it being the responsibility of the auditors to then express an opinion on whether, in their view, they do so.

Section 172 which was formulated after much discussion currently places the primary focus on the directors' responsibility to members having regard to the needs of certain other stakeholders in fulfilling this requirement:

'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,

- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company'

If the responsibility of auditors were to be extended beyond its current scope of being to the members and to extend on a similar basis to certain other stakeholders it would seem necessary to make similar appropriate and consistent amendments to s172 as currently drafted.

Our preference is for auditors to only remain legally liable to shareholders but we would note that even if this is the case not meeting the needs and expectations of other stakeholders clearly has a substantial cost as is currently being witnessed by the auditing profession as a result of the lack of confidence in the way it is fulfilling its responsibilities.

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?

As discussed above, it may enhance voluntary innovation which if successful could in time be adopted more widely across the market.

The most fair and successful reforms we believe would be proportionate liability with a cap based on a multiple of audit fees.

Q44. To what extent (if any) are firms unable to obtain the desired level of professional indemnity insurance to minimise the risk of being unable to meet a significant claim relating to their statutory audit work? How significant is this risk for both the largest firms and other firms undertaking audits of Public Interest Entities?

We believe our current cap is reasonable in practical terms but clearly firms cannot get unlimited cover to match their liability. Based on enquiries made, we also consider we will be able to negotiate appropriate cover to enable us to enter the FTSE350 market if reforms make this a viable proposition though, as we have indicated above, we do not consider the current liability system is fair on auditors.

CHAPTER 10 - OTHER ISSUES

Q45. How far is new technology actually used in audits today? Does the use of technology enable a higher level of assurance to be given?

New technology is being used increasingly in audits today with audit analytics being particularly helpful in assisting with the undertaking of risk assessments and controls testing. Technology is also central to recording the findings of audits and to managing the audit process.

The use of technology can enable a higher level of assurance to be given to the extent it facilitates all items in a population to be checked rather than a sample but whether higher assurance is given will depend on how the test is constructed and how any exceptions from the expected result are followed up.

There is also a far greater range of information available externally on a company than before, by virtue of modern technology, whether in the form of comments on social media or external analyses of the performance of companies in a sector and this can assist in the undertaking of the audit of the financial statements and again is very useful in risk identification and assessment.

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

As discussed above, technology enables a larger number of items to be subject to audit testing with tools identifying items that are exceptions to the norm. Linked to this, it also enables more detailed comparisons to be undertaken between related items than would be possible on an extensive range of issues on a manual basis. Technology can also now be used reliably for analysis of unstructured contextual data which is especially useful for assurance on non-financial information such as that related to organisational culture.

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

Auditing standards need to be reviewed to ensure that they fully take account of the impacts of modern technology.

More generally, we believe a fundamental review of auditing standards is required especially as regards the balance between principles and rules in them. Standards are too prescriptive which results in a compliance rather than a thinking culture in firms with adverse implications for audit quality.

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?

In a market economy, a zero failure of companies is in practice not possible or desirable as different companies will respond with different degrees of success to their marketplace and to changes in their external or internal business environment and it is essential that those best able to meet the needs of their market and of society should be allocated the resources to achieve their goals in the most effective way possible.

The role of audit is to provide reliable information to enable stakeholders, including employees, suppliers, customers, lenders, investors and the government to make decisions in their respective fields based on reliable information that mitigates the advantages insiders otherwise possess and which has a detrimental effect on market confidence. To the extent it does this effectively, it will also provide early warning signs of when businesses are starting to fail or fall behind their competitors at a time when corrective action can be

taken. This is important as corporate collapses though they are on occasions inevitable- as sometimes being able to see a crash coming does not mean it can be stopped- generally result in substantial costs for all stakeholders: employees in terms of lost jobs, suppliers in terms of bills not paid and future orders foregone, lenders in terms of loans unpaid, investors in terms of shares losing their value and governments in terms of tax revenue lost and support needed for communities affected.

We do therefore strongly support the recommendation in the report of the Kingman Review that auditors should have a 'duty to alert' where they consider companies are facing financial difficulties. In many instances if appropriate action is taken, as a result, at an early stage it can avert an insolvency that would otherwise be likely to occur. The auditor has a critical role to play to 'alert' and help stakeholders take the necessary action as early as possible]

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

Whilst we recognise the primary respondents should be the investors and other stakeholders, we do believe auditing is now largely seen as a commodity rather than an essential and independent service providing significant value to shareholders and other users. Some of the enhancements discussed in this response to the 'Call for Views' whilst increasing audit costs would also enhance the value for money of, in particular, the audits of PIE s and other listed companies.

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?

We believe an attempt should be made at making an impact assessment of the benefits compared to the costs of any changes accepting that any such assessment will inherently be subjective. In making such an assessment the views of investors and other users of audit should be to the fore.

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

We believe most shareholders do not make significant use of audit reports but research on this issue as to whether and, if so, how they use them would be helpful with appropriate regard being had to the uses made by various categories of institutional and private investors. It would also be important to identify on which issues users most value information from auditors.

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

There would be significant merit in interaction between shareholders, and also possibly other stakeholders, outside of the AGM especially where the company were facing challenging circumstances and/or where the auditors had concerns on the information being given to them by management and the board though as the audit would not have been completed the auditor would be in receiving and listening mode, and possibly trying to

ascertain relevant insights from shareholders or other stakeholders, rather than discussing the business and their future audit report. To be effective, it is likely arrangements would need to be made for information to be shared with auditors in private rather than in meetings open to all shareholders and other relevant stakeholders.

As discussed previously, it will be important to ensure equal treatment of and access for all shareholders. How this would work in the case of shareholders being able to make private disclosures of concerns to auditors would need to be considered. This is an important practical matter as we believe that the most valuable interactions are likely to be at the planning stage to ensure that shareholders' concerns are reflected in the audit approach and, when appropriate, reported in the financial statements or in the extended audit report.

Q53. How could shareholders express to auditors their ex ante anxieties to help shape the audit plan? Should shareholders approve planning matters for each audit, including scope and materiality?

Shareholders could share ex ante anxieties through contacting auditors and this could possibly be arranged by the auditors setting up an e-mail box for contact on each audit with follow-up meetings set up, where necessary, to understand the issue though, except in exceptional circumstances, the audit committee should also be alerted on the matter concerned. Consideration would also need to be given, as discussed above, to how to facilitate disclosure to the auditor whilst ensuring all shareholders have access to the same information.

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

Shareholders can obtain assurance of varying degrees from a range of external sources including comparative analyses by sector specialists, considering how other shareholders view the company through share price movements and by reviewing publicly available data such as employees' views of the company on Glassdoor and comments, for example, from customers on social media. These, however, are unlikely to compare with a thorough independent analysis by auditors with the necessary skills and independence to undertake a detailed examination, with full access to the company's data, as well as to externally available information, of its performance, position and prospects. On the other hand, auditors should consider whether they can learn from the approach of analysts when undertaking the audits of Public Interest Entities.

In addition to the above, institutional shareholders can also interact directly with the chief executive at analysts' presentations and where they have concerns on corporate governance or other matters with the chair, who they normally see periodically anyway, the Senior Independent Director or the audit committee chair. Audit committee chairs say, however, that they are very rarely invited to meet with institutional shareholders.

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

As the 'Call for Views' indicates in paragraph 136 there is enhanced interest in corporate culture particularly due to the recent changes in the UK Corporate Governance Code emphasising the board's responsibilities in this area.

With boards now expected to set the desired culture, to consider the extent to which the actual culture is aligned to it and to monitor the implementation of programmes to close gaps between them, there is a clear role for assurance on whether the desired culture was determined in appropriate consultation with stakeholders, on the actual culture in the business and on how the extent of success in closing gaps between the desired and actual cultures is being measured and followed up on.

In considering the actual culture, it will be important for assurance to be obtained across the business, at all levels, and in its various operating units through, for example, robust employee engagement surveys and possible surveys involving other stakeholders such as suppliers, customers and investors with these surveys being followed up by appropriate interviews. In addition to understanding stakeholders' views on the company, it will be important to review documented policies and procedures, to consider key decisions made by the company in the period under review and the extent to which the corporate culture and values was evident in the decisions taken. Situations should also be explored where stakeholders had concerns with the company, e.g. employee tribunal and whistleblowing cases and customer complaints. Another key element of the assessment of corporate culture will be the extent to which it clearly plays a critical part in decisions related to recruitment, reward, retention and promotion and how the board and senior management sets the right 'tone from the top'.

We, and we also understand some other firms, have developed a methodology for assessing the culture in an organisation and reporting back on it, and have applied it in practice, but at present the demand from listed companies seems limited.

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

Auditors can help demonstrate that they have exercised appropriate scepticism on each audit by being willing to issue qualified reports on occasion and write challenging extended audit reports especially when done in circumstances which are not considered to be easy, e.g. in organisations where there are dominant business leaders.

The reduction in conflicts of interest through strict limitations on non-audit services that may be provided by the auditor to PIEs and the operational split of the audit practice from the rest of the firm in the case of the Big 4, where audit fees are now generally a fairly small proportion of their total revenue, will also enhance confidence that auditors will not feel under any pressure not to be sceptical.

It will also be important for firms to show in published reports on the practice, e.g. their Transparency Report indicates how they have applied the Audit Firm Governance code, and through their approach to recruitment that they seek to employ and develop individuals who will adopt a sceptical approach.

In addition, well respected regulatory oversight will increase market confidence that appropriate scepticism is demonstrated on each audit.

Whilst we understand joint audit is outside the scope of the Brydon Review, the adoption of joint audit highlights that there will be a significant degree of scepticism exercised on the audit as each firm will review the others' work and our experience is that this is normally undertaken in a thorough manner.

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

This could be provided in the Transparency Report in terms of total remuneration for each partner and with an overarching discussion and analysis of how remuneration is determined. We are not persuaded, however, that the remuneration of individual partners would provide information of significant value to shareholders but will be pleased to hear their views on this issue.

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

The real question is not about the absolute level of fees but whether they provide value for money which we have addressed in our response to Question 49 above.

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

Whilst as an audit firm, we will not respond directly to this question, we generally aim as a firm to be transparent on inputs supporting audit fees with audit committees (time, grades of team involved, timing of the work, etc.) and would be open to audit committees disclosing that information publicly.

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

We believe there is an unparalleled opportunity to revitalise reporting and auditing such that it is better fit for purpose today and in the years ahead. Making the necessary changes would we believe increase the amount of assurance on corporate reports and this would result in some additional costs. Fees would probably also increase as audit moved from being seen as largely a commodity purchase to one that was highly valued by users with wider coverage, higher level of assurance in some areas and differentiated offerings between firms.

We are not generally persuaded by arguments that fees will need to rise and profitability increase if the audit side of the firm is separated from the consulting side. Some assert that due to the latter generally being more profitable than the audit practice it to some extent subsidises the audit side in terms of how revenue is generally allocated between partners in

firms. The alternative view is that it is arguable, for instance, that there are brand benefits in being a highly regulated firm which benefit the whole firm and so to some extent a reallocation of regulatory costs may be appropriate. This would increase the audit firm's profitability without involving an increase in client fees. Similarly, traditionally substantial non-audit work generally flowed from having the audit of major listed companies and so a case can be made that the consulting side of the largest firms should pay the audit firm a fee which would, in effect, reflect the amortisation of the cost of building the relationships concerned in earlier years.

A crucial issue is it is not just the profitability of the audit function that will determine its ability to sustain a high-quality profession. Other significant factors will be the public esteem in which auditors and auditing are held, the opportunities available to those joining audit firms and, in particular, the approach of the regulator to the profession. Young accountants may come to see the auditing profession as one which limits their potential career opportunities and as being constantly subject to criticism by the regulator, with substantial fines being levied on firms and individuals, when errors in procedures are found regardless of intent or impact, the pressures and risks of being an auditor relative to being an accountant with another specialism will be considered to be too high and we will fail to persuade the leading accountants of coming generations to become auditors with significant resultant damage to the public interest.