Response to the Brydon Review's 'call for views'

Submitted by QinetiQ Group plc

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

Provides independent 3rd line assurance to the audited company's Board. Users of published accounts, primarily investors/debt holders and some other interested parties such as NGOs. Sharing of the audit team's knowledge and experience also upskills the Finance function within the company, improving the quality of financial disclosures, reducing the likelihood of misstatement and putting pressure on management to address control weaknesses.

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

Primarily financial statements but audit can test broader context of Annual Report for fair and balanced test and viability of entity.

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?

Don't think this is required as it is well understood. "Reasonable assurance" is appropriate and modern audits are now very thorough. Need to be careful not to seek to achieve an absolute level of assurance as that will never realistically be achievable. Could potentially look at clarifying who the opinion is directed at. Widening this from "the members" of the company should be possible, providing better clarity without necessarily having to change the scope. But need to reflect on who is actually engaging the auditors.

Q4: Do respondents consider there is an expectation gap?

Potentially yes in terms of qualification of users of accounts to understand them, however in practice audit standards and quality are well-defined. But many uninformed parties (e.g. the layman and in some parts of 'the press') may not appreciate this and expect auditors to have caught all frauds and business failures i.e. some commentators believe audit provides 100% coverage and certainty – that is not the case

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

Largely a naïve view of the layman, but at the Board level there shouldn't be a gap. Relative role of Board and auditor is important. Auditors provide assurance but Board must be able to challenge that with sufficient experience. Audit currently provides assurance against material mis-statement. As materiality is reduced, work and cost go up.

The 'gap' is therefore an expression of the difference between the 'value' of 100% certainty that accounts are 'totally correct' v 'materially correct'.

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?

We don't believe so. A challenging audit should provide full assurance to extent possible on financial statements and fraud but less so on business context.

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

One of three layers of assurance but not sufficient in own right. Board and investors should seek corroborative forms of assurance.

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?

Needs to be a common and high standard for listed entities. But does need to be cognisant of, and reflect, the entity's business risks.

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

Yes, but they can/should be complementary.

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

Should use but not rely on such evidence. No need to duplicate effort (at a cost), should be complimentary.

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?

Key is independence and quality of audit team and their process, not innovation for innovation's sake. Any proposed changes to audit should consider implications on the qualities of the audit teams, particularly the Big Four. E.g. impact on individuals' interest in joining/progressing through an audit firm and the experience they gain.

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?

This would be helpful if it could be standardised in approach without making boiler plate. There is a danger that significant more time and effort has to be expended without actually gaining anything extra of value. Risk taking/managing is a necessary part of return making. Risk management needs to be understood in those terms.

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

Auditors should test and comment on quality of internal controls, but primarily responsibility remains with the Board. It would help accounts users, if auditors were required to report explicitly on any controls deficiency - the Sarbox approach is helpful in this regard. Materiality would need to be considered.

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

Yes if significant deficiencies persist, see Q13

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

It isn't clear and is subject to interpretation, although has been enhanced by introduction of viability statement. The requirements of audit in respect of the viability statement should be clarified. But need to be aware that significant more time and effort could be expended without actually gaining anything extra of value.

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 provided they are real and reasonably probable risks and not theoretical or remote.

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

No, the viability statement provides sufficient scope for a robust assessment and when performed well a good stress test. Most business models will fail/become very uncertain if tested against a long enough time horizon. Extending the viability statement could undermine its usefulness.

Q18: Should such a statement be subject to assurance?

Through the Board rather than the auditor. Significant more time and effort could be expended by the auditor without actually gaining anything extra of value. Diluting the assurance from the rest of the audit and increasing costs significantly (both cost of the audit team and cost of internal management time/distraction).

Q19: Who might be capable of giving such assurance?

The Board, if necessary with support from external consultant, but probably not the auditor.

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

Unlikely that the auditor could perform this task, normally would require a consultant or investment banking specialism. It is usually relevant to financial market transactions and a standard part of that process. The auditors would need to invest huge amounts of time to really get to understand the business/market in much more detail.

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?

The existing review process provides adequate assurance.

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

Not usually needed, although there may be some specialist data e.g. CO_2 reporting where specialist assurance is helpful.

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

Believe they are integral and connected and can't be separately assessed.

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?

Not in our experience, they are usually worked in parallel.

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

Auditor narrative reporting is improving and the auditor's perspective provides valuable insight for Board and account users. Increased disclosure in the auditor's report on how conclusions are made is helpful, that is different from providing a graduated opinion however. Recent developments in the audit opinion have helped in this area and now provide quite detailed narrative discussion of key audit matters and how the auditor has addressed those matters. Not sure this can realistically be improved without being Over The Top. It could easily become a difficult report to write. 'Amber Lights' are very helpful.

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

As Q25

Q27. What would prevent such disclosures becoming boiler plated?

Best practice is best pressure here. Specific audit matters have to be company specific.

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

There is good challenge from professional standards and audit quality and technical partner reviews.

But there has been significant innovation and modern IT-analytical techniques allow for much more detailed/thorough/complete review of certain transactions and certain areas of audit risk.

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?

Would view this as essential duty of auditor.

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?

Clearly company law should be paramount but agree that there can be inconsistency and should be up to accounting standards authorities to avoid this.

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

Yes

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?

Yes, but still requires rigour from Board review.

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?

I don't think anything prevents this, it just isn't in demand from stakeholders. Have other stakeholders been consulted?

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?

This is already covered to an appropriate extent through the Audit Committee's and auditors' report.

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?

Yes seems sensible.

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?

Auditors in our experience take fraud seriously, but key issue is their ability to detect, which can be limited if collusion exists.

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

Yes in our experience

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

Not sure a specific test is relevant, but the expectation should be there from Board.

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

Yes

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

Not able to comment

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

Not able to comment

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?

Probably undesirable.

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?

Not able to comment

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?

Not able to comment

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?

Increasingly used, but mainly for transaction testing and still requires experienced judgement to interpret results. Much higher coverage (100% in some areas) through technology potentially enhances fraud detection risk (of some types of fraud) and reduces misstatement risk. This area has seen good progression in recent years.

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?

Primarily in aggregating detailed transaction testing to provide filters for unexpected results and trends

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

Probably driven most by increasing complexity of accounting standards, which is a problem.

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?

The overall standard is key here, which is generally good but clearly some significant issues have arisen.

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

Yes

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?

Increasing cost of audit would not be welcome. Consideration of cost/benefit is very important.

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?

Fairly cursory review

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

Nothing stopping it but rarely seen

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?

This is really Board's responsibility and would expect shareholders to address issues to Board first. The Board (and particularly the Audit Committee) can then shape the audit scope accordingly. Stakeholders can take assurance from the fact that the AC comprises independent non-exec directors.

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

Extensive sources of analytics are available to them, both internal and external

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

Don't think this is their skill set, although they should raise obvious concerns.

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

This is primarily through interaction with the Board and management and then appropriate narrative in the audit opinion.

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

No

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

On the high side

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

Not seen today

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

Not able to comment.