

7 June 2019

Brydon Review Secretariat  
Orchard 1  
1<sup>st</sup> Floor  
1 Victoria Street  
London, SW1H 0ET

By email: [brydonreview@beis.gov.uk](mailto:brydonreview@beis.gov.uk)

Dear Sir/Madam,

**Independent review into the quality and effectiveness of audit - Response to call for views**

We welcome the opportunity to engage with the review in its consideration of the quality and effectiveness of the statutory audit market. Smiths Group plc ('Smiths') is a FTSE100 global technology company listed on the London Stock Exchange. Smiths employs 22,000 people located in over 50 countries and is a world leader in the practical application of advanced technologies. Greater than 95% of the Group's revenues originate outside the UK. Our auditors play a key role in ensuring we provide our key stakeholders with accurate financial and non-financial information.

The overriding objective of audit reform has to be to increase stakeholder confidence in the accuracy and transparency of corporate reporting and in doing so to enhance the attractiveness of the UK as a place to do business. Auditors must be properly incentivised to deliver robust and high-quality audits. Reducing barriers to entry and increasing competition are desirable; and the perceived expectations gap needs to be addressed. However, we disagree that joint or shared audits will achieve these goals. Joint or shared audits will reduce efficiency, raise costs and lead to potential conflict and diminution of consistent standards. The idea of mandating joint audits to select 'large' or 'complicated' groups is questionable and would be open to challenge as to how those terms were defined; small does not necessarily mean simple and vice versa.

We also note that increased regulation in this area is the subject of the Department for Business, Energy & Industrial Strategy consultation on Sir John Kingman's recommendations. Whilst we understand the move toward proportionate and effective regulation as a mechanism for restoring and preserving confidence in the UK audit industry there is concern that the structure of the UK audit industry may be changed in isolation to other jurisdictional regimes such as the US and Europe, thereby creating complexity and inefficiency for UK listed companies compared to their peers subject to these regimes. Any remedies should be consistent with the approach taken by other regulatory bodies.

We have provided comments in respect of the chapters, rather than to individual questions:

## **Chapter 1: Definitions of audit and its users**

Changing the scope of the formal audit would be costly and unhelpful if the UK steps too far away from international norms, particularly in the current climate where inward investment is important. An audit is produced for shareholders, other providers of capital and the primary users of the financial statements, even if other stakeholders rely on its completion. It is not a wider form of assurance on a company's purpose, objectives or performance and should not be relied upon by all stakeholders in place of completing their own reviews. As acknowledged by law and IFRS, all stakeholders with an interest in the financial statements should be able to take comfort from the robustness and quality of the audit process. However, due to the lack of global disclosure frameworks on the front/narrative sections of an annual report, increasing the scope of the statutory audit to provide greater assurance in this area might lead to increased boiler plate reporting.

## **Chapter 2: The 'expectation gap'**

An audit of the financial statements should not be seen as a total assurance process, nor should it be seen as a check and balance on strategic or commercial decisions made by the board. It is not the role of an auditor to tell an investor or other stakeholder whether a business is a good business or a bad one. However, it is recognised that a 'gap' does exist and therefore any changes need to enhance clarity and transparency over what has or has not been assured and the level of assurance given i.e. audit vs limited assurance. We don't believe there is a systemic delivery gap in the actual audit work undertaken in respect of the financial statements and overseen by companies' audit committees, nor that, on the whole, audits have diminished in quality. Isolated instances of lower quality audits have contributed to the existing mood regarding the quality of audit more broadly.

## **Chapter 3: Audit and wider assurance**

Greater use of mandated internal audit work would not help. A sensible audit approach will take account of all relevant internal audit work to avoid duplication, but its use should not be a substitute for formal audit processes. It could be that the use of internal audit and its relative importance could be described better in the audit report. Management and boards already perform significant assurance and verification processes over proposed disclosures and there is little or no evidence to support imposing a model more in line with US internal control requirements which would increase costs and complexity. If the remit of the external auditors were broadened to include information beyond the financial statements the level of assurance would have to vary given the inherent judgemental nature of this information, particularly across different industries, and a lack of comprehensive standards against which to audit.

## **Chapter 4: The scope and purpose of audit**

We don't believe the scope of the audit should be significantly broadened. The UK regime currently requires a broad role for directors in relation to all internal controls as opposed to the US where the focus is on financial controls, and what auditors are required to review. Many companies are subject to the existing UK and US regimes. If change to the UK regime is proposed then a more detailed alignment would be required between this and the US regime in the first instance before extending any audit obligations to non-financial internal controls. Operating under two distinct regimes could prove disjointed and costly, the complications of which would be further exacerbated by the introduction of joint audits. Disclosure obligations already require boards to confirm the results of an assessment of a company's viability, internal control and risk management framework. Although many statements may appear boilerplate, the process and level of analysis undertaken to enable boards to make such statements should not be underestimated. We support the review of viability statements if they are not providing stakeholders with the information expected, and believe this could be extended to checking the sources of finance. The auditors commenting on whether any disclosure is in line with their understanding may go some way to address this, although it should be noted that a company's risk appetite and associated internal control framework is a matter for the board and so the purpose of wider assurance in this area would to some extent be meaningless.

## **Chapter 5: Audit product and quality**

The current binary nature of audit reporting does not help to differentiate companies, even with the recent enhancements/expansion to focus audit work in high risk areas. If auditors were to describe in the audit report graded details around the challenges to management and the results thereof this would be helpful. Clear guidance should be provided to avoid simply adding more boilerplate and differing approaches which may confuse stakeholders in their assessments. The unintended consequences of a graduated approach need to be considered carefully. An opportunity already exists for the regulator to review audit files and the implied robustness of audits.

## **Chapter 6: Legal responsibilities**

The duties of the directors and the auditor of a company are clear in law. The directors are collectively responsible for ensuring the adequacy of accounting records, the accuracy of financial reporting and for promoting the success of the company. To impose an enforcement regime and regulatory sanction targeting specific individuals/roles goes against the very essence of collective responsibility. The PRA and FCA should be consulted on their experience of introducing the Senior Managers and Certification Regime and whether that regime achieved the desired outcome before proceeding with any recommendation. The definition of 'relevant' will no doubt need considering in detail. The auditor's role in assessing whether a company is complying with the relevant laws and regulations should occur as a matter of course during the audit. If conduct would lead to material misstatement of financial statements, then auditors should identify this through their review work.

## **Chapter 7: The communication of audit findings**

In most cases the lead audit partner attends company AGMs at which financial statements are laid in order to answer any questions that may be raised on the audit and/or the financial statements. Therefore, this opportunity already exists albeit informally. The Chair of the Audit Committee is also always available to shareholders to answer questions on the financial statements, the audit and any assurance processes. The annual report and the audit report are both getting longer. Much of what is being written is helpful, but there is little sense of grading and drawing out what is unusual or what should be of interest. If this could be communicated this would help.

## **Chapter 8: Fraud**

Companies should have appropriate controls in place to prevent and/or identify fraud – the oversight of such controls is the board's responsibility not the auditors. If a fraud causes a material mis-statement then the auditors should have designed a sufficiently robust audit process to identify it. Where collusion exists, it will be difficult to identify fraud and stakeholders should not rely on the audit to identify all instances.

## **Chapter 9: Auditor liability**

If the audit covered more than the financial statements it is only right that the audit firms' liability should be extended to cover the additional areas of review and a broader stakeholder group. Consequently it is likely that the associated fees could increase to meet the extended risk of claims from this broader group. For audit firms themselves, the reputational consequence of poor-quality audits and the enforced rotation requirements now act as a self-regulating method of ensuring quality audits. Therefore, the impact of audit rotation should be allowed to bed-in further before significant changes to the scope of the audit market place are proposed/introduced.

## **Chapter 10: Other issues**

Technology/data analytics will have an increasingly important role in enhancing the coverage and quality of audit testing. Key to any audit are interpretation, judgement and scepticism of data and these qualities must not be lost due to increased reliance on technology.

Underpinning our response is encouragement that any reform is commensurate with the enhanced quality of reporting that is likely to be achieved. There has not been sufficient time to review the full impact of other reforms recently introduced with the intention of improving audit quality, all of which will have a delayed impact. To rush into significant further remedies at this stage may prove to be costly and unnecessary and not deliver a proportionate improvement in audit quality and enhanced reporting.

I am happy to meet with the review team to discuss any of the points raised in this letter.

On behalf of the Smiths Group plc Board,

**Mark Seligman**  
**Audit & Risk Committee Chairman**