c/ Chartered Accountants Australia and New Zealand
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12 June 2019

Brydon Review
Orchard 1, 1st floor
Department for Business, Energy & Industrial Strategy
1 Victoria Street
London
SW1H 0ET

By email: brydonreview@beis.gov.uk

Dear Sir Donald,

Submission on the Independent review into the quality and effectiveness of audit: call for views.

The members of the Global Accounting Alliance* (GAA) accept the opportunity to share some views with you. We support this independent review and the approach being taken but stress the importance of considering the international implications of any proposed change. We must all strive to maintain high quality and effective audits of Public Interest Entities (PIEs), and other entities. We believe that the audit profession and audit as a service must continue to evolve. The members of the GAA recognise the importance of ensuring those involved in auditing have the necessary skills and competencies as these will also change within this evolutionary process.

Because you will receive more detailed technical submissions from the member bodies of the GAA and others, we as a global alliance, have focused our submission on key themes relevant to audit around the world.

We welcome the opportunity to consider how audit is working today and what is needed for tomorrow. Any evolution of audit and the audit profession needs to be in the public interest, and any proposed and implemented reforms need to be based on evidence, to show that they are both needed and will achieve higher quality audits. Of course, the audit profession must continue to improve and evolve, but changes need to be considered and targeted to deliver specific, desired benefits and not be to the detriment of the public.

The global audit profession

We believe it is vital that this Review considers the global implications of any changes it may initiate. Auditing is a global profession with national regulation. A report from the International Federation of Accountants (IFAC) indicates nearly 80 per cent of jurisdictions globally have adopted the International Auditing and Assurance Standards Board's International Standards on Auditing (ISAs) and regulators have supported the contents of these standards. Similarly, more than 60 per cent of global jurisdictions adopt the international Code of Ethics for Professional Accountants (IESBA Code) issued by the International Ethical Standards Board for Accountants.

The UK Financial Reporting Council (FRC) adopts the ISAs subject to some additional requirements. The UK professional accountancy bodies also adopt the IESBA Code although in the UK respective members undertaking audit and assurance engagements must comply with the FRC's Ethical Standard.

While the United Kingdom (UK) as a jurisdiction may consider the changes it feels are appropriate for its market, the global implications of proposed changes must be assessed carefully. This includes the implications both on the PIEs being audited and on their auditors, as well as possible implications for the audits of smaller entities. This is not an argument against change but a necessary part of any impact assessment.

PIEs operate globally, and their auditors need to be able to operate globally as well. A large percentage of UK PIEs' operations are based outside the UK. The auditors of these entities are predominantly global audit firms. It would be confusing, and potentially damaging, if changes to the purpose of audit in any one jurisdiction led to inconsistencies between jurisdictions. The harmonisation of the auditing and accounting standards globally has been helpful to the financial markets. Therefore, any proposed changes should clearly articulate the benefits. Such benefits can then be assessed by bodies such as the IAASB as to their suitability for global adoption. Whilst there are undoubted benefits in global harmonisation, we also appreciate that audit will continue to advance, and that regulatory innovation may be led by considered developments in a particular jurisdiction.

The expectation gap

There are many different aspects of the long-established expectation gap; these need to be articulated and analysed separately to come up with targeted and effective solutions to this fundamental issue.
At a high level, the expectation gap is the difference between:

- the reality of the purpose of an audit under the current standards, which is to provide a reasonable level of assurance that the financial statements are free from material misstatement; and
- the understanding and expectations of the public about what an audit provides which include misconceptions such as an audited financial report will contain no errors, that all fraud is detected by an audit, and that companies with a "clean" audit should not fail.

This expectation gap can adversely affect policy changes, particularly where such changes are in response to corporate failures.
There are ways for audit, as a product, to evolve and provide assurance in a range of areas that are important to investors and the public. Particularly through assurance engagements, which are additional to and go beyond opinions on the financial statements. There may be benefit in looking at a modular-design approach to the changes in audit, providing a clear framework for different assurance engagements to be captured within distinct modules that could be applied to entities as appropriate. We believe this is preferable to addressing extended user demands for assurance by adding to the scope of financial statement audits which could exacerbate the expectation gap and would be less scalable. A modular approach could also aid in mitigating the impact of differences between jurisdictions in areas such as the scope of the auditor's responsibilities over all the contents of the annual report. We support this evolution and the work of this Review in this regard.
Improvements in technology will assist. However, untested suggestions can contribute to the expectation gap, for example, that technology itself will facilitate the detection of most fraud. There is a need for education on what is considered an audit today and what it is not, whilst at the same time reviewing its future scope.
Audit is only one part of the corporate reporting ecosystem. The scope of education on the expectation gap should include key aspects of corporate reporting, where the increased requirements on preparers to use fair value accounting has led to increased complexity, subjectivity and judgement in the financial statements. The implications are not well understood. Together with education, consideration needs to be given as to what more can be expected from the corporates themselves in terms of increased transparency on the reporting of an entity's financial performance and position.
The respective responsibilities of the directors of the business and auditors need to be addressed. Such an assessment should include enforcement mechanisms and sanctions for directors who have been found to have breached their fiduciary duties in the preparation of financial statements. High quality corporate reporting along with suitable oversight within an effective system of corporate governance and enforcement will help address the expectation gap.

The impact of technology on the audit

New and emerging technologies are a strong driver of change in how audits are delivered. The full implications of how they may be able to be used to enhance the audit, e.g. to increase the likelihood of fraud detection or improve audit findings, are still to be determined. The cost of investing and developing these technologies and embedding them into audit methodologies is significant, and firms must be able to experiment and assess the costs and benefits of adopting new approaches. Furthermore, regulators and standard setters are themselves still assessing the opportunities and challenges associated with the increased use of technology on audits. This is an area that will continue to evolve.

Wider assurance and the scope of audit

There is scope for consideration of how audit and assurance may be applied in different ways to provide broader assurance to users, on quantitative and narrative reporting. This may include providing assurance on the integrity of business information flows and matters that are increasingly important to investors e.g. a company's reporting of Key Performance Indicators (KPIs) and further alternative or supplementary performance measures. These will likely include certain Environmental, Social and Governance metrics which will undoubtedly continue to gain in importance in the coming years, alongside the broader adoption of Integrated Reporting. Additionally, assurance over internal controls is another option that may be useful to help companies better convey the reliability of an entity's underlying control framework. This could be adopted voluntarily, or it could lead to enhanced reporting requirements being introduced.

Graduated findings
There is merit in exploring how more graduated audit reporting might provide enhanced insight for users. Interaction between the audit committee and the auditor will be key. The directors themselves will, in the first instance, need to provide more detail and nuance in their disclosures, particularly regarding going concern, estimates, and impairment.

Cost/benefit analysis
Where changes of a fundamental nature are being considered, a cost/benefit analysis needs to be undertaken. This assessment will need to take account of both qualitative and qualitative costs and benefits. Ultimately, there is a need for all stakeholders, including investors, corporates, regulators and auditors to play their part in ensuring that audit remains fit for the purpose for the 21st century. The member bodies of the GAA stand ready to play their part. There are projects already underway in several the members of the Alliance, which may be of interest to the Review and assist in this evolutionary process. Details will be supplied separately.

Yours sincerely,

Stephen Harrison AO FCA
Chief Executive Officer
Global Accounting Alliance

* **The Global Accounting Alliance (GAA)**
The Global Accounting Alliance (GAA) was formed in November 2005 and is now an alliance of 10 leading professional accountancy bodies in significant capital markets. Working together to represent around 1,000,000 professional accountants in over 180 countries around the world. It was created to promote quality services, share information and collaborate on important international issues. The GAA works with national regulators, governments and stakeholders, through member-body collaboration, articulation of consensus views, and working in collaboration where possible with other international bodies, especially the International Federation of Accountants (IFAC).
The Alliance facilitates a co-operation between 10 of the world's leading professional accounting organisations:

- The American Institute of CPAs (AICPA)
- Chartered Accountants Ireland (CAI)
- Chartered Professional Accountants Canada (CPA Canada)
- Hong Kong Institute of Certified Public Accountants (HKICPA)
- Chartered Accountants Australia and New Zealand (CA ANZ)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Institute of Chartered Accountants of Scotland (ICAS)
- Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW)
- The Japanese Institute of Certified Public Accountants (JICPA)
- South African Institute of Chartered Accountants (SAICA)