



Audit Quality

An audit committee survey

KPMG Board Leadership Centre

July 2020

Audit quality

Audit committees serve the interests of investors and other stakeholders through their independent oversight of the annual corporate reporting process, including the audit of the company's financial statements. The audit committee is responsible for the appointment of the external auditor, approval of their remuneration and any non-audit services commissioned. The audit committee is also tasked with challenging the auditor over the quality of their work and, through its interactions with the auditor and with the other directors and management, can play a key role in facilitating a high-quality audit.

Recent audit reforms have emphasised both the fundamental role of audit committees in effective stewardship and the importance of an effective, high quality, statutory audit. Further changes may be required to respond to the recommendations of the Competition and Markets Authority (CMA) study of the statutory audit services market. These changes are likely to include increased regulatory scrutiny of audit committees, including to ensure that they select auditors based on the quality of audit rather than other criteria. Other reviews, for example Sir Donald Brydon's independent review of the quality and effectiveness of audit, may also result in new requirements and recommendations that audit committees should remain alert to.

In this survey we set out to better understand audit committee perceptions of audit quality by asking FTSE350 audit committee chairs a number of questions about how auditor scepticism, challenge of management and audit quality has changed over the past three years. A total of 127 FTSE350 audit committee chairs took part in the survey between 2 and 16 June 2020.

*Due to the design of the survey tool, only the data from the 80 fully completed questionnaires was recorded and factored into this report.



Key takeaways



Audit committees believe they receive high quality audits

A clear majority (89%) of audit committee chairs responding to the survey believed they received high quality audits. Only three percent didn't believe they receive high quality audits.



More evidence of auditors demonstrably challenging management

A clear majority (82%) of audit committee chairs responding to the survey believed there was more, or significantly more, evidence of auditors demonstrably challenging management than three years ago. Only one percent of those responding experienced a reduction in evidence of challenge.



An upward trend in audit quality

A clear majority (65%) of audit committee chairs responding to the survey perceived an improvement in audit quality over the past three years. Only three percent of those who responded disagreed with the statement.



Data and analytics has enhanced audit quality

A clear majority (79%) of audit committee chairs responding to the survey believed the increase in data and analytics over the past three years had enhanced audit quality. Only two percent of those responding believed the increase in data and analytics over the past three years had diminished audit quality.



Increased professional scepticism

A clear majority (68%) of audit committee chairs responding to the survey agreed that, in their experience, auditors demonstrated more professional scepticism than three years ago. Only seven percent did not perceive an increase in professional scepticism.



Views divided on the impact of greater regulatory focus on the audit practice as a whole

FTSE350 audit committee chairs were evenly split as to whether greater emphasis by regulators on the operation of the audit practice as a whole, in a similar way to the regulation of financial services companies, would enable them to better assess audit quality. Almost as many audit committee chairs disagreed with the statement (28%) as those that agreed (30%).



On balance, operational separation will have an adverse impact on audit quality

While around a quarter (23%) of audit committee chairs responding to the survey believed operational separation would enhance audit quality and improve the standing of the audit profession; almost twice as many (47%) thought that operational separation would have an adverse impact.



Audit fees will increase in the light of audit reform

A clear majority (67%) of audit committee chairs responding to the survey believed that audit fees would increase over the next three years in the light of the audit reforms heralded by the recent regulatory reviews (i.e. Kingman, CMA, Brydon).



CFO or audit committee? Views divided on who is the audit partner's key contact

FTSE350 audit committee chairs were evenly split on the question as to whether the audit committee chair is regarded by their lead audit partner as their most important contact on the audit. Almost as many audit committee chairs disagreed with the statement – generally citing the CFO as their key contact.



Inspection findings very rarely adversely impact an audit committees perception of audit quality

Whilst a majority (62%) of audit committee chairs responding to the survey noted that regulatory inspection findings had not changed their perception of the quality of the audit firm involved, a significant minority (17%) reported an improvement in their perception of the quality of the audit firm as a result of the regulatory review. Only three percent had their perception of audit quality reduced.

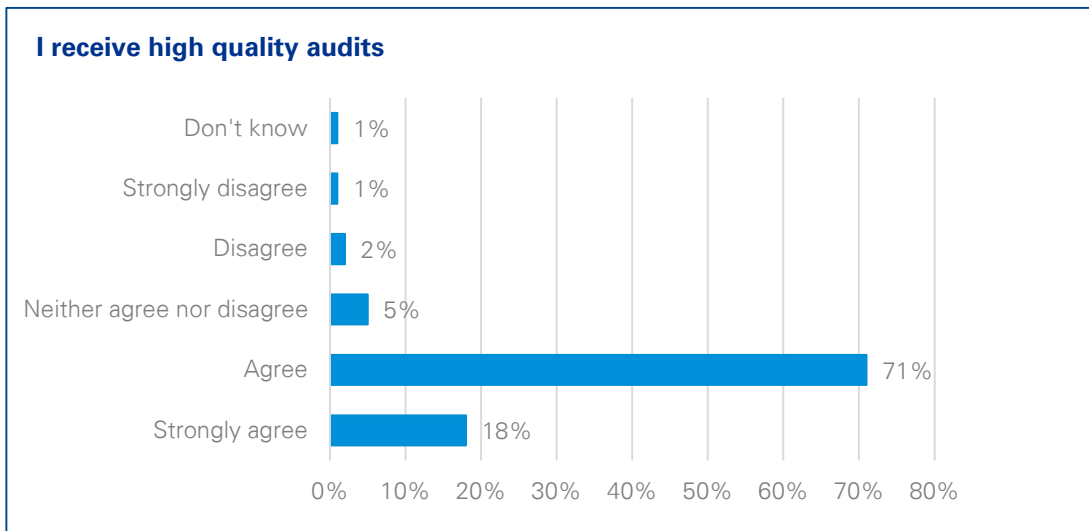


The top five audit quality indicators

The top five audit quality indicators considered to be of most relevance to audit committee chairs when assessing audit quality were: the quality of the signing partner; observable challenge and professional scepticism; the ability of the signing partner to interpret and apply complex accounting judgements; the quality and clarity of reporting; and the external inspection results.

The perceived quality of FTSE350 audits

We asked FTSE350 audit committee chairs whether, in their experience, they receive high quality audits.



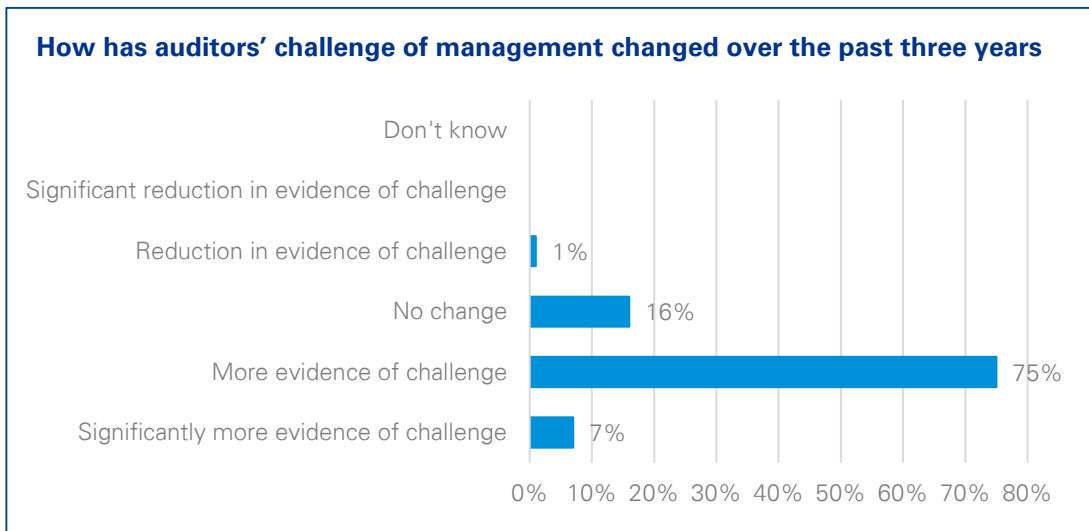
A clear majority (89%) of audit committee chairs responding to the survey believe they receive high quality audits. Of the small number (3%) that didn't believe they receive high quality audits, the reasons cited were:

- First hand experience of audit failure
- Not enough insight into the quality of reporting
- A perception that the audit is done for the regulator, not for the company

One responder noted that the AQIs presented by the auditors are generally inputs to process rather than impacts. Auditors should open up their quality assurance processes, the impact of specialists, performance ratings and training data – and then provide a detailed and meaningful AQI report at the end of the audit.

Demonstrable challenge of management?

We asked FTSE350 audit committee chairs whether, in their experience, auditors' challenge of management has improved over the past three years.

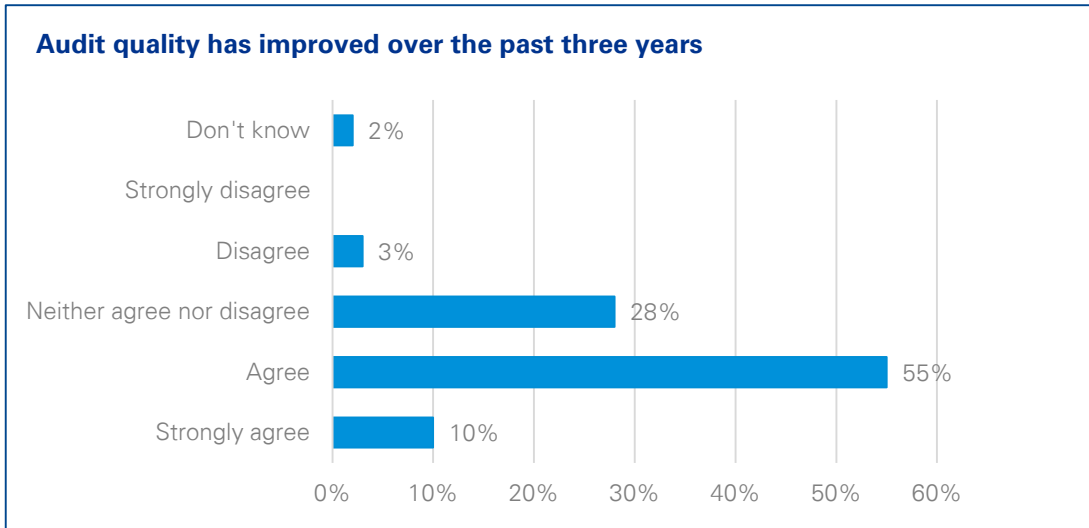


A clear majority (82%) of audit committee chairs responding to the survey believed there was more, or significantly more, evidence of auditors demonstrably challenging management than three years ago.

Only one percent of those responding experienced a reduction in evidence of challenge.

An upward trend in audit quality

We asked FTSE350 audit committee chairs whether, in their experience, audit quality has improved over the past three years.

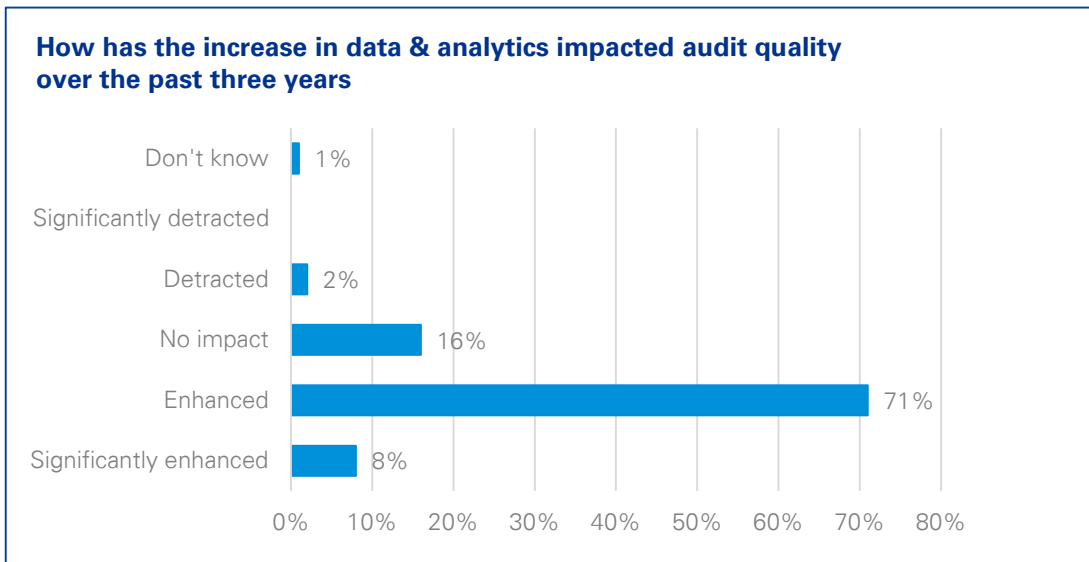


A clear majority (65%) of audit committee chairs responding to the survey perceived an improvement in audit quality over the past three years. Around a quarter of those responding neither agreed nor disagreed that audit quality had improved.

Only three percent of those who responded disagreed with the statement. Reasons cited included the perception of substantiating work done to satisfy regulators to the detriment of audit quality and less robust assurance on the front end of the annual report.

The impact of data and analytics on audit quality

We asked FTSE350 audit committee chairs whether, in their experience, the increase in data and analytics has enhanced audit quality over the past three years.

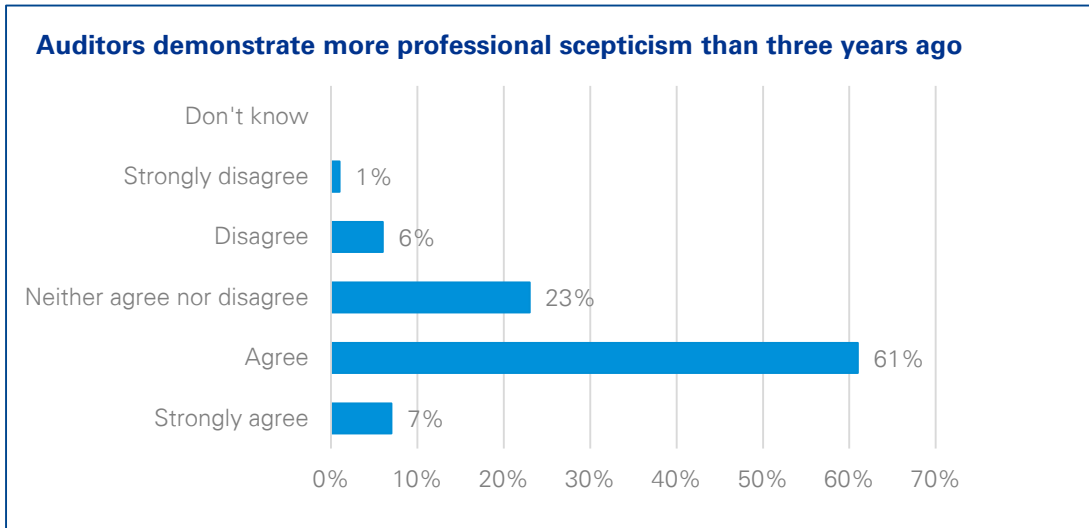


A clear majority (79%) of audit committee chairs responding to the survey believed the increase in data and analytics over the past three years had enhanced audit quality.

Only two percent of those responding believed the increase in data and analytics over the past three years had diminished audit quality.

An increase in professional scepticism

We asked FTSE350 audit committee chairs whether, in their experience, auditors demonstrate more professional scepticism than three years ago.



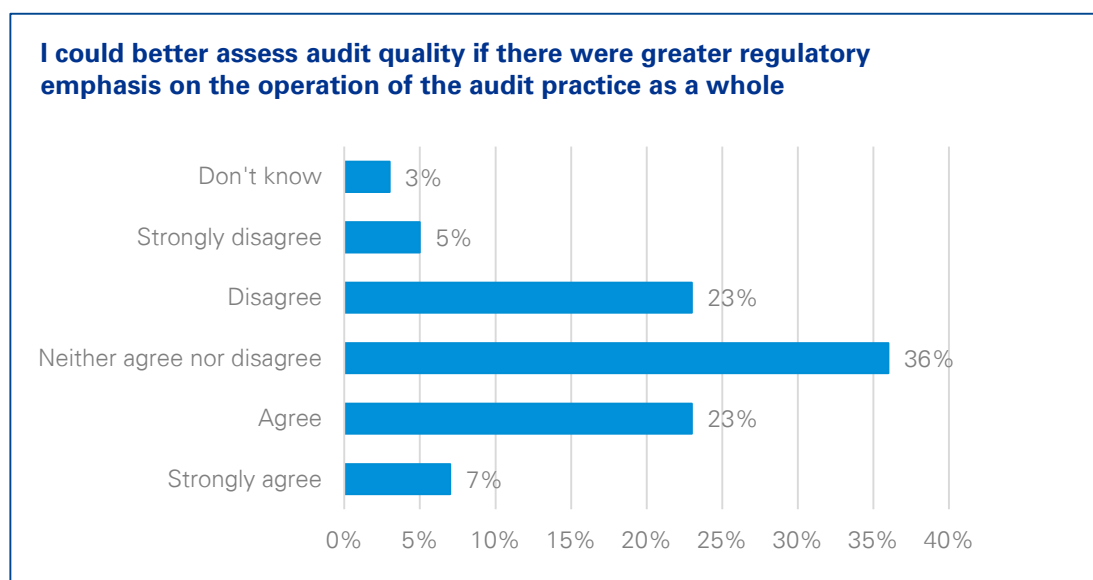
Over two-thirds (68%) of audit committee chairs responding to the survey agreed that, in their experience, auditors demonstrated more professional scepticism than three years ago.

Only seven percent did not perceive an increase in professional scepticism. Reasons cited included:

- No improvement, but satisfied with what I have experienced (two responses)
- Having more professional scepticism hindered by auditors with less business understanding (one response)
- Professional scepticism is reactive and driven by protecting the audit profession from regulatory investigations rather than the investors and users of accounts (three responses)

Regulatory focus on the audit practice as a whole

We asked FTSE350 audit committee chairs whether they could better assess audit quality if there were greater emphasis by regulators on the operation of the audit practice as a whole, in a similar way to the regulation of financial services companies.



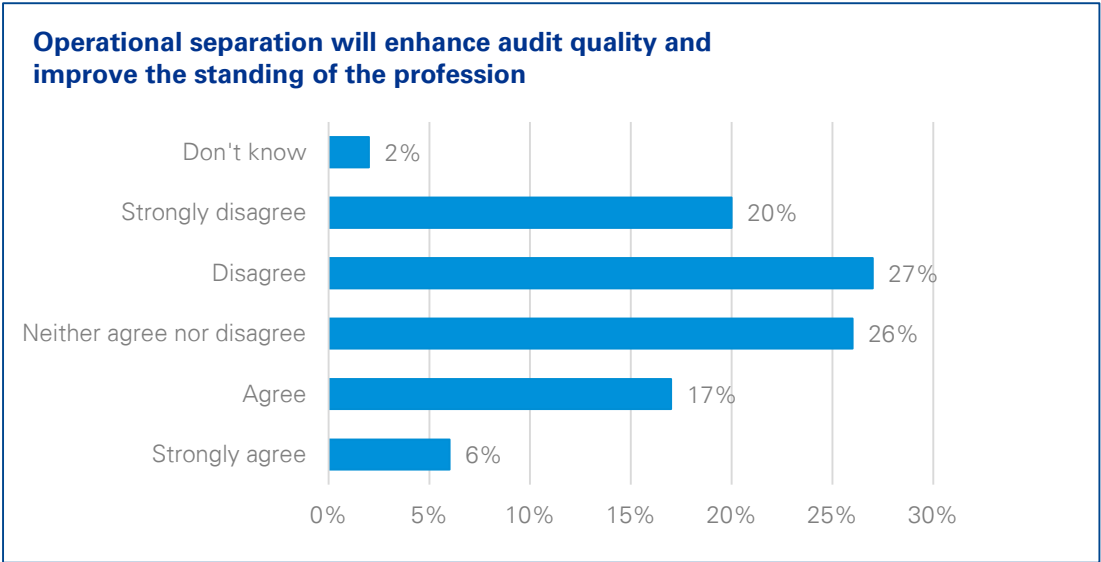
FTSE350 audit committee chairs were evenly split as to whether greater emphasis by regulators on the operation of the audit practice as a whole, in a similar way to the regulation of financial services companies, would enable them to better assess audit quality. Almost as many audit committee chairs disagreed with the statement (28%) as those that agreed (30%). Around a third neither agreed nor disagreed.

Of the 28 percent of audit committee chairs who did not believe such regulatory focus would help them better assess audit quality, the reasons cited fell into the following broad categories:

- Increased regulation doesn't drive audit quality (44%)
- First and foremost audit quality resides with the individual audit teams (22%)
- I already have sufficient tools to assess audit quality (17%)
- Regulation at audit practice level will adversely impact audit innovation (11%)
- The emphasis should be on empowering the audit committee (6%)

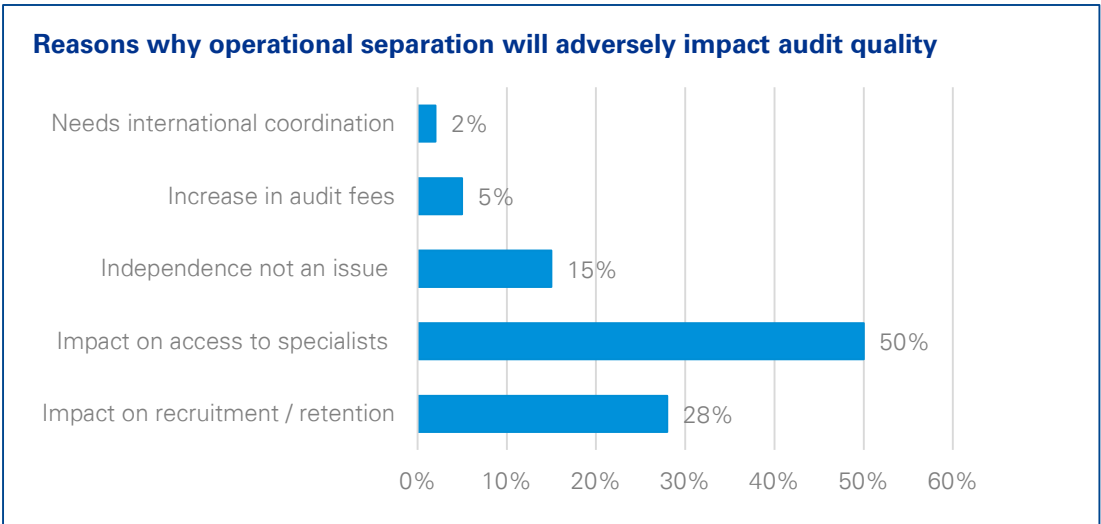
The impact of operational separation on audit quality

We asked FTSE350 audit committee chairs whether operational separation (of audit within a multi-disciplinary firm) will enhance audit quality and improve the standing of the audit profession.



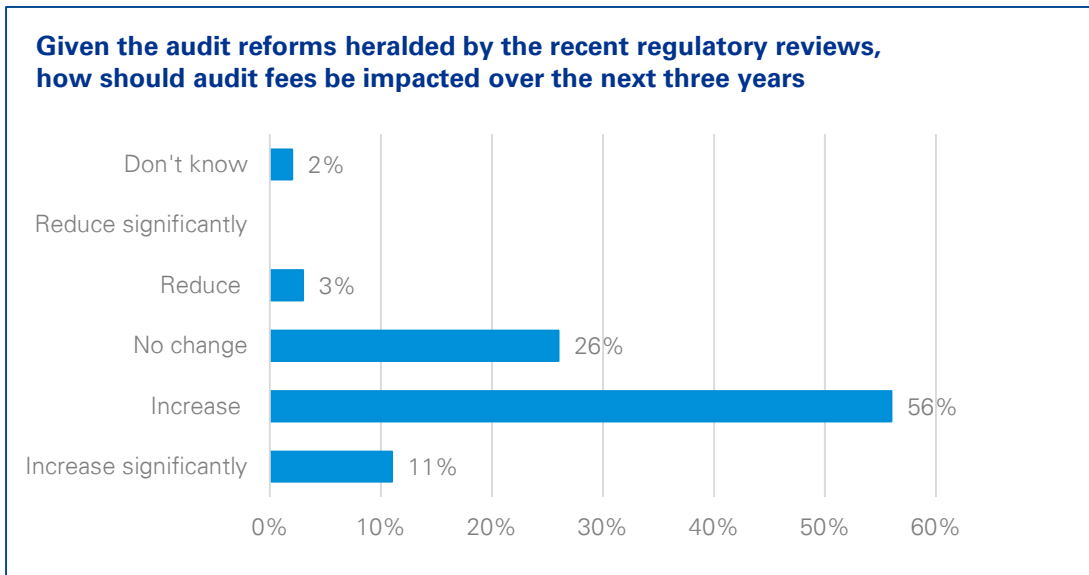
While around a quarter (23%) of audit committee chairs responding to the survey believed operational separation would enhance audit quality and improve the standing of the audit profession; more than twice as many (47%) thought that operational separation would have an adverse impact on audit quality and the standing of the audit profession. The reasons cited by those that considered operational separation to have a negative impact included:

- Adverse impact on recruitment/retention of talent into audit
- Adverse impact on access to specialists
- Independence no longer an issue due to existing regulation and prohibitions on NAS
- It will simply increase audit fees
- Ineffective in the absence of international coordination



The impact of the proposed audit reforms on audit fees

We asked FTSE350 audit committee chairs how audit fees will be impacted over the next three years in the light of the audit reforms heralded by the recent regulatory reviews (i.e. Kingman, CMA, Brydon).

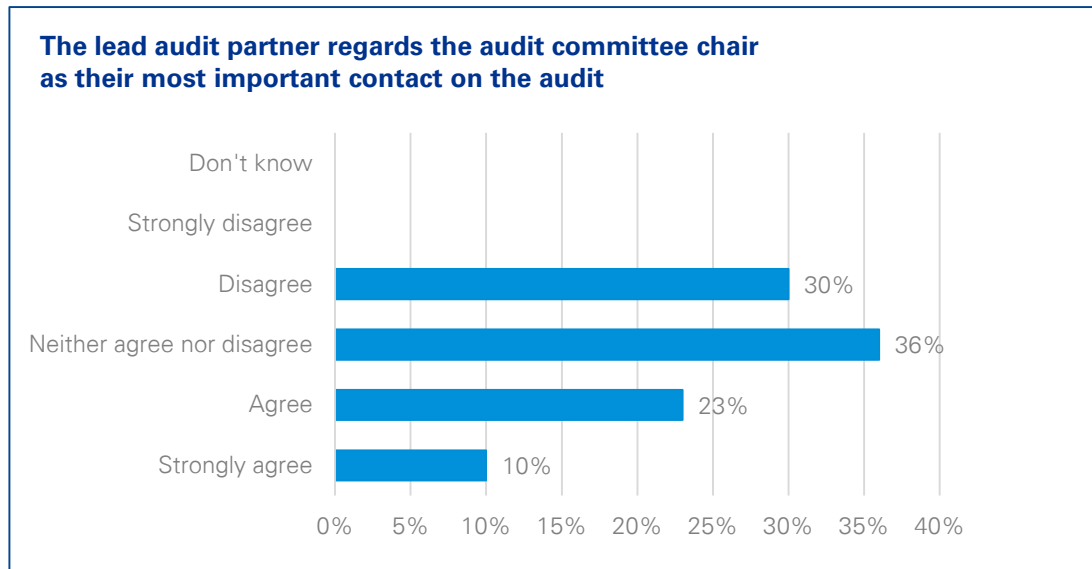


A clear majority (67%) of audit committee chairs responding to the survey believed that audit fees would increase over the next three years in the light of the audit reforms heralded by the recent regulatory reviews (i.e. Kingman, CMA, Brydon).

Only two percent of those responding believed audit fees would reduce in the light of the audit reforms.

The audit committee chair as the auditor's main contact

We asked FTSE350 audit committee chairs whether, in their experience, audit committee chairs are regarded by lead audit partners as their most important contact on the audit.

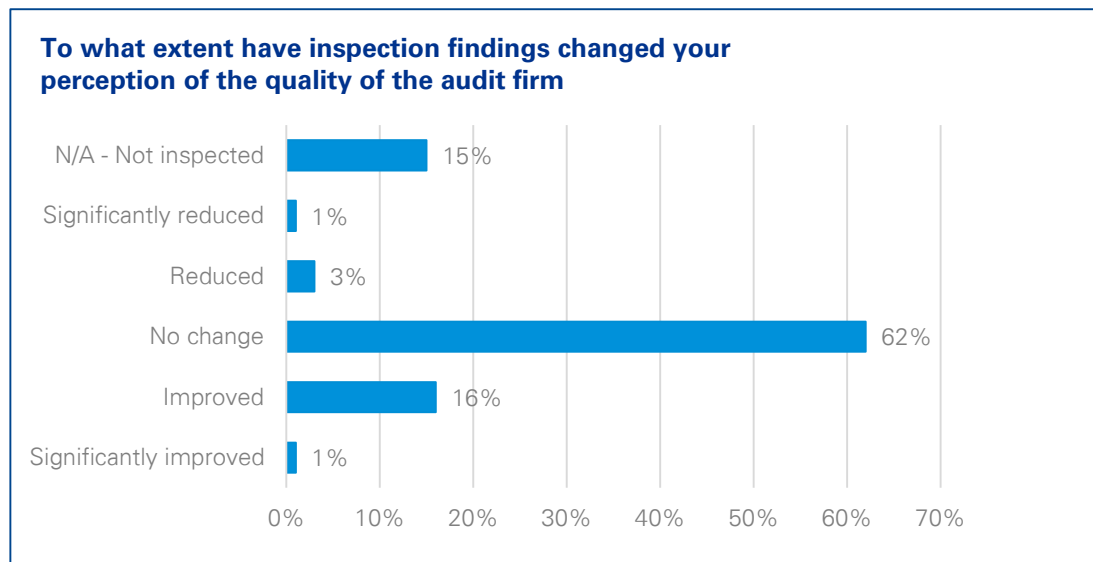


FTSE350 audit committee chairs were split on the question as to whether the audit committee chair is regarded by their lead audit partner as their most important contact on the audit. Almost as many audit committee chairs disagreed with the statement as those that agreed. Around a third neither agreed nor disagreed. After 25+ years of governance reforms in this area we might have expected the lead audit partner's relationship with the audit committee chair to be viewed more universally as of equivalent strength to that with the CFO – three sides of an equilateral triangle based on mutual respect and recognition that each party has its role to play. However, as can be seen below. Many audit committee chairs believe it appropriate for the CFO to be the lead audit partner's main contact on the audit.

Of those audit committee chairs who did not believe their lead audit partners regarded them as their most important contact on the audit, the vast majority (80%) considered the most important relationship to be with the CFO or equivalent. Other reasons cited included: the key relationship being with the audit committee as a whole; the relationship with the CFO and audit committee chair being equal; and the key relationship being with someone (unspecified) within the audit firm itself.

The impact of inspection findings on perceived audit quality

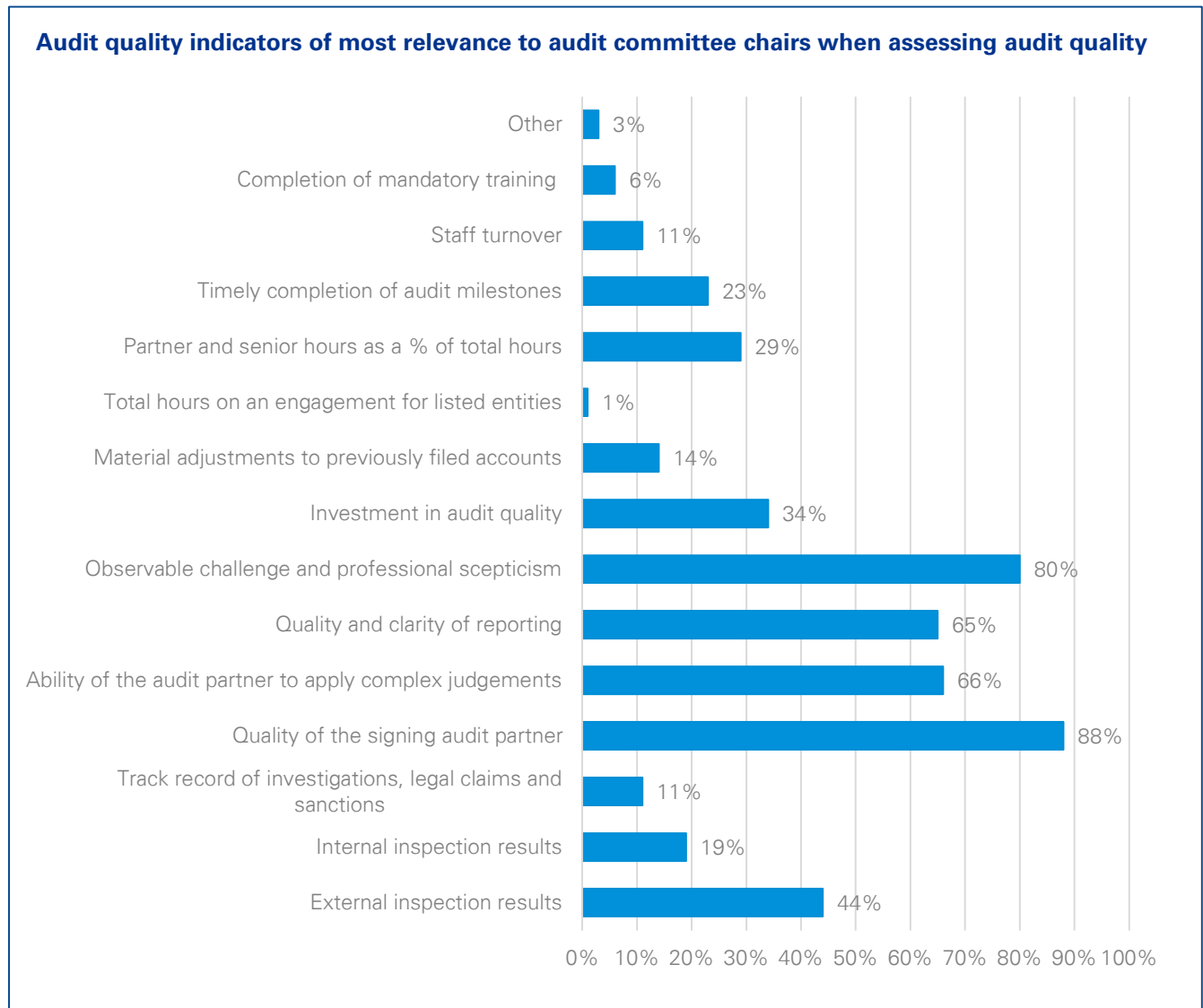
We asked FTSE350 audit committee chairs whether, for audits that have been inspected by a regulator (e.g. AQR, PCAOB), the inspection findings changed their perception of the quality of the audit firm involved.



Whilst a majority (62%) of audit committee chairs responding to the survey noted that regulatory inspection findings had not changed their perception of the quality of the audit firm involved, a significant minority (17%) reported an improvement in their perception of the quality of the audit firm as a result of the regulatory review.

Audit quality indicators: A balanced scorecard

Thinking about the potential information in a balanced scorecard on audit quality, we asked audit committee chairs to identify the top five audit quality indicators that would be of most relevance to them when assessing audit quality.



The top five audit quality indicators considered to be of most relevance to audit committee chairs when assessing audit quality were:

- The quality of the signing audit partner – including experience, portfolio and workload
- Observable challenge and professional scepticism
- The ability of the signing audit partner to interpret and apply complex accounting judgements
- The quality and clarity of reporting
- External inspection results (AQR, QAD, SEC)

Perhaps unsurprisingly, the four (potentially, five) most cited indicators were audit specific indicators rather than firm-wide indicators.



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Contact us

Timothy Copnell

Board Leadership Centre

T: +44 (0)20 7694 8082

E: tim.copnell@kpmg.co.uk



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