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Fraud Detection and Prevention: A Review of the Latest Developments in U.K. Audit

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Proposed reforms to U.K. audit are reviewed from a fraud detection and prevention perspective. A holistic four-actor model that encompasses: the directors, auditor, shareholders, and the regulator, is used to frame the discussion. Focus is drawn to the mediating role of the Audit and Assurance Policy. The paper argues that the proposed reforms have some potential to reduce the audit expectations gap. However, the problem of agency costs and the advisory nature of shareholder voting on the Audit and Assurance Policy significantly limit the possible effectiveness of the reforms from a fraud detection and prevention perspective. Suggestions for future research are made.

Keywords: fraud, audit, expectations gap, agency costs, corporate governance, advisory voting

Introduction

The unprecedented rise in corporate collapses of prominent U.K. companies like Carillion, Palmer and Harvey, Patisserie Valerie, and BHS has ignited the debate about audit quality and directors conduct. In the U.K., the Big Four and Mid-Tier audit firms' failures to pick up material misstatements in their clients' books have further increased the concern on whether the current audit approach is fit for today, let alone for the future.

In the wake of the Carillon collapse in 2018, the U.K. government commissioned three interconnected reports: Kingman (2018); CMA (2019); and Brydon (2019) to address concerns with the quality of U.K. audit and regulation of the audit profession. Kingman's opinion of the current regulator of audit—the Financial Reporting Council ("FRC")—was particularly hard hitting. The FRC was considered to be a "timid…ramshackle house" (Kingman, 2018, p. 5) that was not fit for purpose. And, whilst some stakeholders considered that the quality and effectiveness of much[1] traditional auditing was currently "good enough" (Brydon, 2019, p. 4), there was still significant scope for improvement. Put simply: "even though [U.K.] audit [was] not broken … it [had] lost its way" (Brydon, 2019, p. 4).

After considering the findings of Kingman, CMA, and Brydon, the U.K. government recently published a set of proposals that create a dramatic reform package that is likely to change U.K. audit significantly (BEIS,

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[1] Under increasing governmental pressure, the FRC has admitted that "a third or audits carried out by the seven largest [UK] firms [are] in need of improvement or significant improvement" (FRC, 2020, footnote 1, p. 14 of BEIS).

2021). At the center of the proposals stands the aim of creating a new *corporate audit profession*. Currently, audit is merely an aspect of the accountancy profession that the FRC regulates via the accountancy professional bodies. The new standalone profession will make a “clean break with audit’s ties to accountancy” (BEIS, 2021, p. 120) and be overseen by a new professional body, and a new regulator.

The new corporate audit profession’s scope of work is potentially far broader than the traditional financial statement audit. Corporate auditors will still undertake the *statutory audit* of the financial statements, but they will also engage in *wider audit* activities. Some of these wider audit activities will be mandated by relevant legislation, whilst other activities will be commissioned voluntarily by companies and their shareholders in a market-led manner (BEIS, 2021). To enable these wider audit activities, the new profession will require a “range of skills” that will require “appropriate education” and “tailored qualifications” (pp. 117-118). An important component, but not totality, of such skills and education, will be *forensic accounting* specific. A skill set that, historically, has been used to detect and investigate *fraud*.

The corporate audit profession will also require a “distinctive mindset” (BEIS, 2021, p. 119). This mindset will require corporate auditors to be appropriately *suspicious* (p. 101) in their audit work. Currently, traditional auditors are required to be sceptical in their audit approach (IAS, 200), but are not required to be suspicious. A suspicious mindset is closely linked to the effective detection, prevention, and investigation of *fraud* (Wolosky, 2004; DiGabriele, 2008).

Awolowo (2019) previously argued that a key problem with the traditional audit is that it fails to utilise the forensic accounting mindset and associated forensic accounting skills to detect and prevent fraud appropriately. Awolowo argued that if auditors adopt a fraud detecting mindset, this could reduce the *audit expectations gap* (Ruhnke & Schmidt, 2014). This gap is a metaphor that describes the difference between what traditional financial statement auditors actually do, and what the general public perceive they do.

The U.K. government is now proposing to embed forensic accounting skills, and a fraud detection mindset, into the new corporate audit profession. It is also giving shareholders the opportunity to request wider audit work that could specifically address fraud detection and prevention issues. Given that Awolowo’s argument preceded the publication of the BEIS proposals, we suggest that there is both theoretical and empirical support in adopting a fraud detection and prevention perspective to analyse the latest developments in U.K. audit. As such, this paper aims to critically analyse the BEIS 2021 proposals from a fraud detection and prevention perspective.

The paper proceeds as follows. Firstly, a theoretical framework consisting of four actors and a mediating policy shall be established. The four actors will consist of the directors; auditors; shareholders; and the regulator. The mediating policy will be argued to be the Audit and Assurance Policy. Specific issues connected with the *directors*, the *auditors*, and the *regulator* will then be considered in turn. Finally, a concluding discussion will be offered. This will include a theoretically informed consideration of the challenge of *shareholders* engaging meaningfully in their stewardship role connected with preventing and detecting fraud.

The Agency Diamond—A Four-Actor Mediated Model

Previous studies on fraud detection and prevention have often adopted an agency theory (Jensen & Meckling, 1976) based approach. For example, Awolowo et al. (2018) developed an agency triangle to provide a visual description of this approach. The agency triangle focused upon three key actors: directors (agent); shareholders (principal); and external auditors.

A review of the relevant professional and political literature (Kingman, 2018; CMA, 2019; Brydon, 2019; BEIS, 2021) demonstrates the importance of all of these three key actors. However, the BEIS (2021) report makes the empirical observation that a market-led approach to the detection and prevention of fraud, driven by the traditional three agency actors—directors, shareholders, and auditors—has not led to a “spontaneous change” (p. 102) in an audit. To create effective change, the BEIS report argues that a new empowered *regulator* is required to impact the quality and effectiveness of audit and, by implication, the prevention and detection of fraud. This demonstrates the presence of a fourth key actor previously unrecognised in the agency triangle: the audit regulator. In fact, the BEIS report specifically calls for a *holistic* approach that includes the regulator by definition. Accordingly, we choose to include the following four actors in our theoretical model: the directors, auditors, shareholders, and the regulator.

A key way by which the relationships between these four actors will be mediated (Engestrom, Miettinen, & Punamaki, 1999) will now be explained. Here we use the concept of mediation to refer to a written policy that has the power to influence behaviour and relationships between actors.

The U.K. government are proposing that Public Interest Entities, but not all companies, present an Audit and Assurance Policy in the annual report and account that sets out the directors’ approach to audit and assurance over a rolling three-year period (Brydon, 2019; BEIS, 2021). This policy will explain the board’s approach to the nature and scope of:

- *Statutory* audit of the financial statements and *wider* external audit work,
- Directors’ *attestation* statements and related independent audit *assurance*, and
- Internal audit and assurance work.

The Audit and Assurance Policy will be proposed by the directors and, for companies with a premium stock market listing, will be subject to an advisory shareholder vote at the AGM (BEIS, 2021). This policy will provide a mechanism whereby engaged shareholders will have the potential to impact the scope of audit work undertaken. By clarifying the nature and scope of the mandatory statutory audit—and voluntary wider audit work—shareholders will be able to better understand the role and scope of the new corporate audit profession in the context of individual companies. From a fraud detection perspective, this policy will give shareholders the potential to influence the board to obtain specific fraud detection services if considered necessary.

Presenting a policy about directors’ attestation statements and related independent auditor assurance will also help shareholders better understand the reasons for the scope and level of the attestation and assurance provided by both auditors and directors. Significantly, engaged shareholders will be able to scrutinise the policy and, by inference, make an argument from absence as to why certain director attestations or auditor assurance commitments are—or are not—being given. This will help shareholders better understand the assurance they are being given about fraud detection and prevention.

In summary, the Audit and Assurance Policy will mediate the relationship between key actors (Engestrom et al., 1999) of Public Interest Entities. This four-actor model, which is mediated by the Audit and Assurance Policy, is shown in Figure 1.

The analytical model presented in Figure 1 will be used to frame the paper presented. Given its graphical form, we refer to it as the *agency diamond*.

Our analysis will begin with a consideration of two key issues specifically connected to directors and fraud prevention: directors’ attestation statements and directors’ clawback and malus provisions.

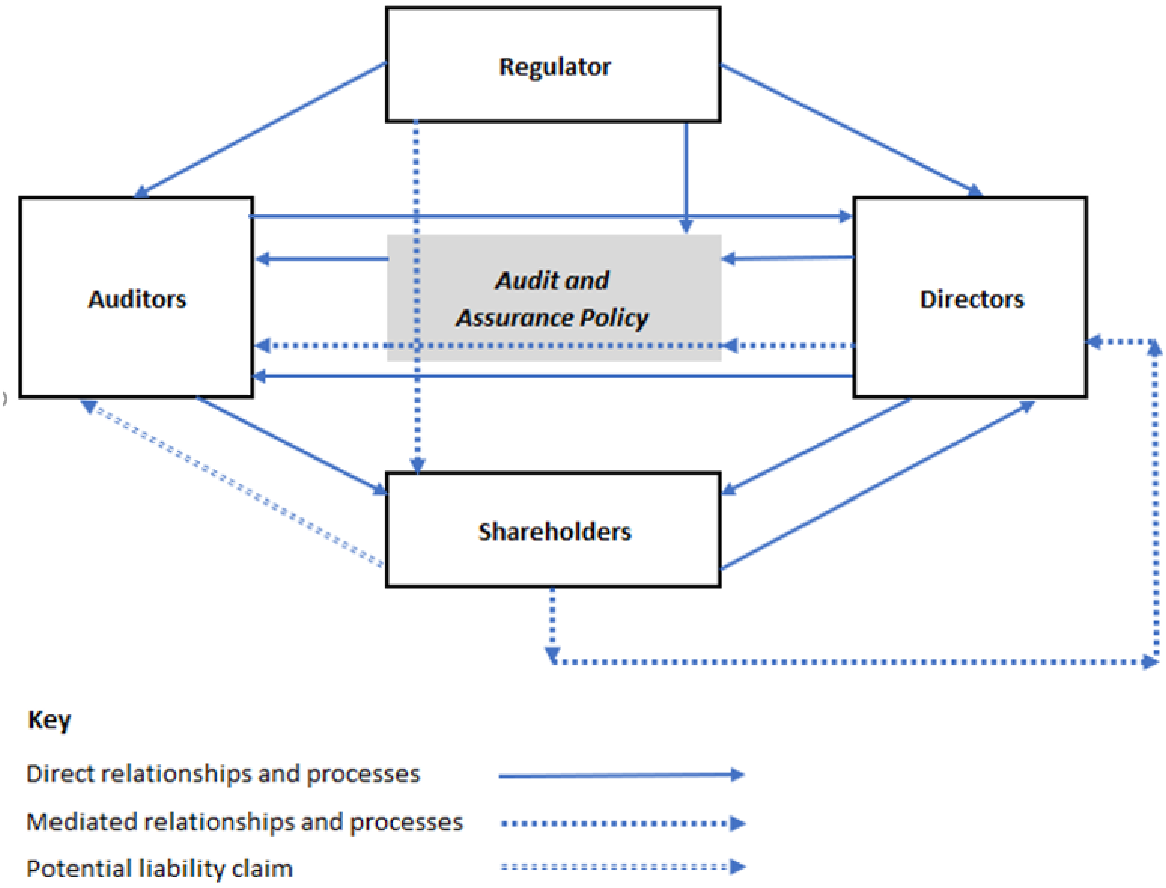

Figure 1. The agency diamond: a four-actor mediated model.

Directors and Fraud Prevention

Directors' Attestation Statements

Directors' attestation refers to directors affirming that the statements that they make formally about particular aspects of governance are a genuine, even truthful, expression of the known facts. To this end, the government is moving to require directors to attest to various governance issues and, most particularly, to provide attestation about the internal controls and risk management systems of a company (BEIS, 20218). This is an important development in combating fraud in the U.K., as high quality, internal control systems can reduce the risk of fraud (Donelson, Ege, & McInnis, 2017). However, it must be noted that attestation about internal control systems carries only the potential, not the inevitability, of improving director conduct and preventing fraud (Ugrin & Odom, 2010).

Most specifically, from a fraud perspective, the government is also proposing to make it mandatory for the directors of Public Interest Entities[2] to "report on the steps that they have taken to prevent and detect material fraud" (BEIS, 2021, p. 103). Auditors will then have to conclude as to whether or not, this directors' statement is "factually accurate" (BEIS, 2021, p. 104). Moreover, the auditors will be "required to report on the steps they took to detect any material fraud and assess the effectiveness of relevant controls" (p. 104).

[2] The proposals would initially only extend to premium listed companies, and would then be extended to PIEs after two years (BEIS, 2021, p. 49). They would not cover smaller companies in the UK.

The exact details of all the possible directors' attestation statements and the extent to which external auditors will be required to provide assurance about these statements have yet to be confirmed. It is a vexed issue. In theory, strong and detailed attestation statements, combined with reliable, independent auditor assurance, could provide both shareholders and stakeholders with high levels of assurance. In the U.S., for example, the SOX regime combines specific directors' attestation statements about internal control systems with high levels of external auditor assurance. But, despite some of its advantages, the US SOX system has been criticised for the high agency costs that the attestation and assurance processes involve (Hostak, Lys, & Yang, 2013). As such, the U.K. government has entered into a consultation process (BEIS, 2021) before making a firm commitment as to how director attestation and external auditor assurance should be enacted in the U.K. market.

These proposals have the potential to enhance the way that directors govern and auditors audit fraud-related matters. However, our critical reading of the proposals suggests that the government is *not* recommending that the legislation will require auditors to provide assurance that specifically asserts that there has been no fraudulent activity. If shareholders want specific assurance with regard to fraud-related matters, they will have to find a way of influencing the board to draft the Audit and Assurance Policy accordingly.

Clawback and Malus Provisions

A way of potentially deterring poor executive behaviour regarding fraud prevention and detection is to build specific clauses into directors' employment contracts that trigger re-payment of remuneration received—if executives are found to have acted negligently (Chen & Vann, 2017). Such arrangements are commonly referred to as clawback and malus provisions.

Under the current regulatory structure, the *U.K. Corporate Governance Code* states that directors' remuneration policies should: "include provisions that would enable the company to recover and/or withhold sums or share awards [from directors] and specify the circumstances in which it would be appropriate to do so" (UK CGC, 2018, p. 14). Such clawback and malus provisions can include specific reference to fraud-related issues, such as misconduct and a material failure to govern internal controls effectively. However, it appears that many companys' current clawback provisions are not as strong as the government wants, hence the government's proposal seeks to stimulate companies to strengthen these clawback and malus provisions. The government also wants to strengthen the power of the regulator to ensure that "remuneration can be withheld or recovered [by the regulator] in the event of serious director failings" (BEIS, 2021, p. 91). This would allow for clawback to be made in high profile scandals where non-executive directors had either failed to implement, or trigger, robust clawback arrangements.

Enforced clawback and malus provisions are unlikely to prevent, or detect, all types of fraudulent activity. But, from a shareholder and wider stakeholder perspective, appropriately designed provisions—when triggered and enforced—could influence stakeholder perceptions about how seriously fraud is taken and punished in civil society. Furthermore, we suggest that if the regulator influenced the design of these provisions in a way that highlighted fraud, this would provide a way for fraud prevention and detection to be brought more clearly to the attention of directors. We also note that there is scope for such clawback arrangements to move beyond just executive directors to encompass non-executive directors[3].

[3] It must also be noted that these malus and clawback arrangements only impact companies that need to comply with the *UK Corporate Governance Code*, and this necessarily omits the vast majority of companies in the UK.

Auditors: The New Corporate Audit Profession

The next actor to be considered is the auditor who, under the new proposals, will be a member of the new profession of corporate auditors[4].

It is commonly acknowledged that there is an *expectations gap* (Ruhnke & Schmidt, 2014) in the U.K. with respect to the role that stakeholders think that statutory external auditors perform and the actual role that such auditors perform. Brydon clearly recognised this, saying that the expectations gap was "the most complex and misunderstood of all the topics [he] reviewed" when looking at the quality and effectiveness of U.K. audit (Brydon, 2019, p. 65). In our opinion, this gap is particularly evident in respect to understanding the role that auditors play with regard to the detection of fraud.

Our interpretation of the BEIS report suggests that the proposals appear to attempt to reduce this expectations gap. They do so by proposing: (i) changes to the way that auditors are trained; (ii) highlighting the need for auditors to take an agency theory view of directors' conduct; and (iii) giving shareholders an opportunity to influence the commissioning of wider scopeaudit work that could potentially cover fraud specific issues, via the Audit and Assurance Policy.

These three interconnected proposals will now be considered.

Changes in the Way That Auditors Will Be Trained

Historically, auditors have "tended to view fraud-related audit procedures as a compliance exercise rather than an important part of the audit" (BEIS, 2021, p. 104), based upon a presumption that fraud is unlikely to arise (FRC, 2014, p. 5). This view describes one possible causal explanation for the audit expectations gap. To reduce this gap the government recommends that fraud awareness and forensic accounting training be embedded into the initial training and continuing professional development of corporate auditors (BEIS, 2021, p. 104). The BEIS report hopes that this proposal will change the "mindset and skillset" (p. 104) of all corporate auditors and reduce the audit expectations gap in the eyes of the public (BEIS, 2021). This is a significant development from a forensic accounting and fraud education perspective.

Auditor Suspicion of Director Conduct

The BEIS report also finds auditors are not always taking sufficient account of director conduct (Brydon, 2019; BEIS, 2021, p. 93). This observation supports the agency theory assumption that directors might not behave in a manner that aligns with shareholder wealth creation and wider stakeholder benefit (UK CGC, 2018). To address this concern, the new corporate auditing profession will be required to have a specific mindset that incorporates inter alia, appropriate scepticism and suspicion (Brydon, 2019, p. 42; BEIS, 2021, p. 101). This further change in the "mindset" of all corporate auditors has further potential to reduce the audit expectations gap in the eyes of the public. It might also, in certain circumstances, increase the probability of auditors detecting fraud.

Potential for Voluntary—Wider Scope-Audit Work

The new corporate auditor profession will be qualified to undertake a much wider, and more challenging scope of work than a traditional audit. Such be spoke, and potentially higher risk, corporate audit work could occur when engaged shareholders use the Audit and Assurance Policy as a mechanism to request wider audit

[4] They will no longer be an accountancy professional who is a registered statutory auditor of annual accounts, who works for an approved firm of accountants.

work. An example of such higher risk corporate auditing would be providing specific assurance on fraud detection that goes beyond mandatory reporting.

However, additional fraud-specific audit work is likely to be challenging and costly to audit. Managing the potential agency costs of such work and the implications of auditor liability for poor quality corporate audit are likely to be significant. Particularly as the Brydon review identified a “deep anxiety” (Brydon, 2019, p. 68) amongst auditors about how their work can be perceived when prejudicial hindsight is applied after frauds are exposed *after* an audit has taken place. We consider this critical issue of the agency costs related to fraud prevention and detection more fully in the discussion section of this paper.

Regulator

The next actor in the agency diamond to be considered will be the regulator.

The Audit, Reporting, and Governance Authority (“ARGA”)

The U.K. government wants to establish a new regulator whose remit will include regulating the new corporate audit profession. The new regulator’s remit will also cover the traditional accountancy profession, corporate reporting, and corporate governance issues. Practically the current regulator, the FRC, is to be “remodelled” (2014, p. 18), and a new regulator created: the Audit, Reporting, and Governance Authority (“ARGA”) established (Kingman, 2018; BEIS, 2021). ARGA will be expected to proactively enforce regulation and not behave in the timid and often reactionary manner that the FRC used to act before it came under recent significant scrutiny. It is hoped that it will become a stronger, more robust, legitimately independent regulator. Yet, for the purposes of this paper, it must be noted that its remit is far broader than simply fighting fraud. Moreover, combating fraud is not foregrounded in the government literature as a key aspect of ARGA’s prospective role. We have, however, identified the following specific issues that we consider have the potential to impact the prevention and detection of fraud.

New Enforcement Powers

ARGA will get new powers to enforce the statutory duties of *all* directors (BEIS, 2021, p. 89). In contrast, the current regulator has no direct powers to act if directors’ duties are breached unless the director is a member of a professional accountancy body (BEIS, 2021, p. 84). Widening the audit regulator’s enforcement ability to bring actions against all directors and not just directors who are professional accounts could broaden the attention given by all directors to fraud.

A specific example of an existing statutory duty that ARGA could enforce would be the duty of all directors to provide information and explanations at the request of the auditor (Companies Act, 2006, pp. 418, 499). Such representations effectively force all directors, not just professionally qualified accountants, to tell the auditor if they know anything about any fraudulent activities happening within the company. This simple disclosure has the potential to both deter and uncover board-level fraud. However, even though effective discharge of this duty exposes potential director’s fraud, it might not necessarily reveal hidden employee fraud or collusion fraud.

These new enforcement powers also mark an important regulatory change with respect to enforcing actions against directors of both insolvent *and* solvent companies. With regard to fraud, failure to discharge a director’s duties with regard to audit and corporate reporting are criminal offences under the Companies Act (2006). In such cases, negligent directors are typically prosecuted by the Insolvency Service—but only in cases where the fraud is connected with a company that has become insolvent. It is rare for actions specifically related to audit to be brought against directors of solvent companies[5] (BEIS, 2021). We argue that widening the new regulator's scope of enforcement powers against all directors of both solvent and insolvent companies has, over time, some potential to have a beneficial impact on the prevention and detection of fraud.

Technical Support for a New Regulator

To better understand the potential implications of introducing a new regulator, we now deepen our discussion by presenting a short technical review of how the existing regulator has recently dealt with clarifying the technical link between audit and fraud.

The Brydon report (2019) recommended that the current regulator, namely the FRC, amend the current auditing standard on fraud (IAS (U.K.) 240, 2000) "to make it clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways" (Brydon, 2019, p. 66; BEIS, 2021, p. 103). However, a review of the amended standard (IAS (U.K.) 240, 2021) shows that the FRC has *not* included a clear and unambiguous statement saying that the auditor has to detect fraud specifically. Under the revised standard, auditors simply have to design procedures to detect *material misstatement of the financial statements* (IAS (U.K.) 240, 2021, 8) and obtain representation from the directors that the directors believe that they have, inter alia, appropriately fulfilled their responsibility as directors to create an appropriate internal control system to prevent and detect fraud (IAS (U.K.) 240, 39). They are not charged with specifically attempting to detect fraud.

What is notable about the revised fraud auditing standard is that, rather than extending the scope of the audit to necessitate specifically investigating potential fraud, the main textual change appears to be written in a manner that specifically protects auditors if they fail to detect fraud. It does so by clarifying that an auditor only requires a reasonable level of assurance that they have "plan[ned] and perform[ed] the audit to ensure that the financial statements are free of material misstatement due to fraud" (IAS (U.K.) 240, 7.1, 2021). Auditors do not have to seek "absolute" assurance that this is the case. The difference between what a traditional auditor considers is reasonable assurance with regard to fraud detection and what a member of the public might expect is, in our opinion, the very definition of the so-called audit expectations gap.

Moreover, the other changes to IAS (U.K.) 240 made by the FRC appear to be minimal and largely cosmetic. For example, some of the new text simply recommends that audit engagement team members merely "exchange ideas … about fraud risk factors" (IAS (U.K.) 240, 15.1, 2021). As such, the authors of this paper are minded to suggest that the alterations to IAS (U.K.) 240 are unlikely to significantly reduce the so-called audit expectations gap with regard to fraud.

Notwithstanding the newly introduced requirement of IAS (U.K.) 700 for auditors to: "explain to what extent the audit was considered capable of detecting irregularities, including fraud", even when given a specific chance to strengthen the U.K. fraud auditing standard, our analysis demonstrates that the FRC did not make significant changes, even though it claims to (O'Dwyer, 2021). From a fraud prevention and detection perspective, this analysis clearly gestures towards supporting the policy decision to create a new audit regulator, ARGA.

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[5] This extends to other actions brought under other criminal charges via other law enforcement agencies in the UK such as the Serious Fraud Squad, National Crime Agency, the Police and Companies House, for example (BEIS, 2021, p. 84).

Discussion

Summary Overview

The U.K. government's key proposals pertaining to Public Interest Entities, which can impact fraud prevention and detection, are summarised below.

Directors

- Will have to make an annual statement about "the steps that they have taken to prevent and detect material fraud" in the Annual Report and Accounts;
- Will be encouraged to create meaningful clawback and malus provisions that would be triggered for legitimately negligent behaviour with regard to fraud prevention and detection;
- Will be required to present an Audit and Assurance Policy at the AGM that specifies the nature of both: (i) the mandatory; and (ii) voluntary audit work, that will be undertaken—and the associated auditor assurance and director attestations that will support this.

Auditors

- A new profession—*corporate auditing*—will be created;
- Corporate auditors will have a different "mindset and skillset" from traditional financial statement auditors;
- Corporate auditors will be required to be "suspicious";
- Forensic accounting skills, including fraud detection and prevention, will be embedded into the new professionals' training;
- Corporate auditors will continue to undertake the mandatory audit, but;
- May be retained to offer additional wider audit services—if required—by the Audit and Assurance Policy;
- Will be required to state if the directors' statement about fraud prevention and detection is factually accurate.

Regulator

- The new regulator, ARGA, will regulate the new corporate audit profession in a more robust manner than its predecessor;
- Will have the power to enforce the statutory duties of all directors, not just professional accountants.

Shareholders

- Shareholders will be given the opportunity to have an advisory vote on the Audit and Assurance Policy that the directors will propose at the AGM.

As developed in this paper, these interconnected changes, appear to have potential to improve fraud prevention and detection in Public Interest Entities. However, it can be seen that these proposals will not give absolute assurance as to whether there is specifically no material fraud; they will only provide a reasonable level of assurance. As such, we will now consider how shareholders could, if they wanted to, increase the level of assurance they were given about fraud detection and prevention. To initiate this discussion, we will now problematise the role of the key mediating policy: the Audit and Assurance Policy.

Audit and Assurance Policy

The proposed introduction of an Audit and Assurance Policy is a new development in U.K. corporate governance. When it is actually introduced, it will give directors an opportunity to specify: (i) the scope of *additional* audit work that the new corporate auditors will be require to undertake for individual companies, and (ii) the level of specific attestations and assurance that shareholders will be given with regard to matters that are *beyond the scope* of those that are mandated by law and regulation. For the purposes of this paper, this could include additional fraud prevention and detection work that goes beyond that which is mandated by law or regulation.

The Audit and Assurance Policy will provide shareholders with a mechanism by which they might be able to gain higher levels of additional assurance with regard to fraud detection and prevention, beyond the reasonable assurance that auditors will be expected to provide. This could occur if engaged shareholders were able to influence a board of directors to include additional, fraud specific, work in the policy. However, we will now argue that agency costs and the advisory nature of the voting on the policy are likely to significantly diminish the latent power of this policy regarding additional fraud specific audit work or director attestations.

Agency Costs

Agency costs refer to the cost to the company of directors and auditors, providing appropriate assurance to shareholders. For the purposes of this argument, we will ignore the cost to the company of enhancing internal control mechanisms to prevent and detect fraud. Instead, we will consider the fee that the corporate auditors will charge the company for any additional audit work done.

For high risk audit work, such as work connected to fraud detection and prevention, an audit fee is comprised of two key components: a charge for the actual audit work done, plus an uplift to take into consideration any potential liability claims made against an auditor at a later date. We argue that potential liability claims against auditors are significant issues that need to be considered in this discussion. For example, KPMG is now facing a writ for £250m for alleged deficiencies in their audit of Carillion plc in 2018 (Clarence-Smith, 2021).

Brydon recognised a “deep anxiety” (Brydon, 2018, p. 68) amongst auditors about how their work can be perceived when prejudicial hindsight is applied after frauds are exposed after an audit has taken place. Or, more simply, auditors are only likely to be willing to take on additional, high risk, fraud specific audit work if they are able to charge sufficiently high fees, and limit the scope of their assurance in a way that protects them from future potential liability claims based upon hindsight. Such fees increase the agency cost to the company.

We are uncertain as to how shareholders will react to the chance of commissioning additional audit work, against the potential agency costs of commissioning such work. Whilst the U.K. government has created the potential for shareholders to request additional fraud specific work, the extra agency costs involved might disincline shareholders to attempt to influence boards to commission additional work via the Audit and Assurance Policy.

It must also be recognised that shareholders will not have an immediate ability to decide upon the scope of additional audit work dictated by the Audit and Assurance Policy. The directors will ultimately decide upon the policy, and shareholders will only be given an opportunity to cast an advisory vote on the policy. It is to this policy that we now turn.

Advisory Voting on the Audit and Assurance Policy

Firstly, it is important to clarify why the U.K. government is proposing the introduction of an Audit and Assurance Policy. The main motivation appears to stem from criticisms of shareholders for “poor stewardship” (BEIS, 2021, p. 17) and the government’s desire for shareholders to engage more meaningfully with the audit process. We concur with this aim and suggest that this change has the potential to encourage greater shareholder engagement and enhance shareholders' awareness of their stewardship responsibilities.

But, closer scrutiny of the proposals indicates that the engagement opportunities that shareholders are likely to be offered might not be sufficient to enhance meaningful change in all companies. Most specifically, and only for Public Interest Entities with a premium stock market listing, the Audit and Assurance Policy will be subject to an *advisory* shareholder vote at the annual general meeting (BEIS, 2021). An advisory vote does not provide a guaranteed mechanism for shareholders to explicitly dictate what the policy should be. It only provides shareholders with an opportunity to signal to the board whether they are happy with the policy or not.

Currently the remuneration policy is subject to a binding shareholder vote every three years, and the remuneration report to an advisory vote each year (Companies Act, 2006, Ch. 9). However, historically in the U.K., voting on remuneration at the AGM was advisory. Thus, the prior literature on U.K. advisory voting on remuneration is informative when considering the potential impact of the proposed introduction of an advisory vote on the Audit and Assurance Policy.

Enhanced remuneration report disclosures that are subject to advisory voting have been argued to be a "poor surrogate" for meaningful engagement by shareholders (Harvey, Maclean, & Price, 2020). And, Convon and Sadler (2010) only found limited evidence that advisory shareholder votes—that gave a "say on pay"—had a material impact on CEO remuneration policy design prior to 2010. We are minded to suggest that the proposals are only likely to significantly impact board policy where market-led sentiment and meaningful shareholder engagement outside of the formal AGM meeting are powerful enough to facilitate effective change. The role of meaningful shareholder engagement here is crucial.

In rebuttal to our sceptical view articulated above, we also note that the government is proposing that a transparent and formal mechanism be established that will allow shareholders to comment upon the auditor's proposed audit plan each year. A formal response to shareholder concerns would then be made (BEIS, 2021). This mechanism would, in theory, allow shareholders to make suggestions as to additional annual audit work that they thought was necessary. However, based upon our previous discussion of agency costs, we remain sceptical about how effective such a mechanism might be in creating meaningful engagement between shareholders and auditors.

Suggestions for Future Academic Research

Based upon our discussion, we now suggest three avenues for potential future academic research in this area.

Firstly, from a quantitative methodological perspective we suggest that there will be an opportunity to consider the advisory voting patterns of shareholders at AGMs with regard to the Audit and Assurance Policy. There will also be an opportunity to consider the additional agency costs related to the additional audit fees associated with such work, as far as appropriate disclosures are made available.

Secondly, a potential avenue for research using a qualitative approach will be to analyse the "structured dialogue" about resolving the "obstacles" that need to be overcome when seeking to resolve the inherent tensions between audit quality, agency cost, and auditor's liability (BEIS, 2021, p. 115). The government has requested that such a dialogue take place between shareholders and auditors. We suggest that analysis of these discussions could lead to informative insights with regard to agency issues.

Finally, from a theoretical perspective, there is an urgent need to develop our analytical understanding of agency costs and auditor's liability (Nikkinen & Sahlstrom, 2004; Simunic, 1980, as cited by: Dedman, Kausar, & Lennox, 2014). The empirical work we suggest with regard to advisory voting and actual agency costs might, both inform, and be informed by, such theoretical developments.

Limitations

The paper presented has three significant limitations.

Firstly, the paper has foregrounded the issue of fraud prevention and detection. However, a critical reading of the literature that this review has been based upon (Kingman, 2018; CMA, 2019, Brydon, 2019; BEIS, 2021) shows that whilst being an issue, fraud prevention and detection is not the key issue that the government is seeking to address. Fraud is only part of the challenge of "restoring trust in audit and corporate governance" (BEIS, 2021, p. 15).

Secondly, the majority of the proposals discussed in our review will only impact Public Interest Entities. They will not impact all U.K. companies. This significantly limits the potential scale and impact of the proposed changes, and the scope of our review. The government's argument for limiting the scope of the legislation is that other companies, particularly smaller firms, typically have "more concentrated ownerships" (BEIS, 2021, p. 99) whose shareholders are "less likely" (p. 99) to benefit from the proposed changes, than the shareholders of PIEs. We have not explored this issue any further.

Finally, at the time of writing, the details about exactly what directors will attest to have yet to finalised. We have not provided any commentary on the relevant advantages or disadvantages of specific forms of directors' attestation.

Reflection on Awolowo's Previous Argument

To draw the paper to a close, we return to our introductory motivation for the paper that was driven by Awolowo (2019). Awolowo envisaged a world where auditors would be trained like forensic accountants and have a detective mindset. Being the bloodhounds of book-keeping, they would have the capacity to sniff out fraud and criminal transactions (Crumbley, 2009). These book-keeping bloodhounds would be able to provide shareholders with more than a reasonable assurance that there were no material fraud issues; they might even be able to offer absolute assurance.

However, our opinion at the time of writing is that rather than becoming Awolowo's faithful, absolutely dependable bloodhounds, the U.K. audit profession might—despite a change in name, mindset, and skill set—continue to be a fee sensitive profession that seeks to specifically limit the scope of its work and protect itself from future liability claims brought in hindsight against it.

Conclusion

Our review has shown that the U.K. government is proposing to make some significant changes to how fraud detection and prevention are enacted in Public Interest Entities. The proposals are based upon a holistic approach that, to be effective, will require appropriate engagement from four key actors: the directors, auditors, shareholders, and the regulator. Much of this meaningful engagement will be mediated by a new innovation: the Audit and Assurance Policy. This paper has argued that these proposed changes have the potential to improve fraud detection and prevention. However, due to agency costs and the voluntary nature of the shareholder vote on the Audit and Assurance Policy, the extent and effectiveness of these changes cannot be predicted reliably at present. Future empirical research will be needed to ascertain their impact.

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