

Corporate Accountability Network Audit Briefing – wha...

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As I [have noted previously on this blog](#), the [Corporate Accountability Network](#), which I direct, is publishing a series of Audit Briefings that discuss the need for audit reform in the UK. The [background to this series](#) is noted here.

In previous briefings, [I have addressed the question of what accounts are and what public interest entities, or \(PIEs\), might be](#). The issue as to [who the stakeholders of PIEs might be](#) has also been considered. All the [links are to be found here](#).

In this briefing, I turn to another issue, which is what the information needs of the stakeholders of PIEs might be. The [relevant briefing is to be found here](#).

As the Briefing notes:

It is our suggestion that the purpose of accounting has to be properly understood if the audit of financial statements is in turn to be properly appreciated. We suggest that:

The purpose of accounting is to provide the stakeholders of a reporting entity with financial statements that include relevant, reliable and sufficient information which allow them to make informed decisions.

We suggest that in this context relevance is defined by the stakeholder's need, reliability means free from material misstatement and that sufficiency is determined in relation to the stakeholder's purpose in requiring the information that should be disclosed. It is our suggestion that the fulfilment of these objectives should together represent a new meaning for 'true and fair' fit for the twenty first century.

We suggest that a great many of the audit failures of recent years have arisen as a result of the failure of accounts to supply relevant, reliable and sufficient information. Resolving this one issue, which will in due course require reappraisal of UK accounting standards and a reconsideration of the appropriateness of IFRS standards, would contribute considerably to the resolution of the audit crisis that the UK has suffered. It would also close much of the audit expectation gap.

Producing symmetries between the purpose of accounting and the purpose of audit is, in our view, a prerequisite to good policy in our view. Audit has suffered what has been described as an expectation gap for as long as anyone now working in the profession has been engaged in it. The most likely explanation for this expectation gap is that auditors have believed it to be their duty to report solely to the shareholders of a company on whose financial statements they report, and then solely with regard to the appropriateness of the information included within those financial statements for the purpose of supporting decisions on whether a shareholder wishes to engage with the company, or not. As we note in the next section of this Audit Briefing, there are many more stakeholders who have interest in the accounts of a PIE than just its shareholders. As we also note later in this Audit Briefing, those stakeholders have a wider range of reasons for requiring accounting data from a PIE than most shareholders have.

We suggest as a consequence that the purpose of audit should be redefined. This redefinition should focus upon the supply of information that meets the needs of all users of financial statements of a PIE whilst giving auditors a proactive responsibility to ensure that these needs are met.

This point about the proactive role of auditors builds on sentiment within the Brydon Review. It also reflects our review of the history of financial reporting and the role that auditors have historically played within its development, frequently demanding data from companies in earlier eras that might not have otherwise been made available.

It is our suggestion in that case that the auditor has a duty to decide not just on the adequacy of the data that a PIE might include in its accounts, but also quite specifically upon what might be missing from those financial statements that a stakeholder might require, and to then either demand its inclusion or alternatively supply it based upon the data that it can secure from the PIE, or to explain why that it is not available. The auditor does, in that case, have a proactive role in the provision of accounting data.

Our resulting suggested definition of an audit is:

The purpose of the audit of a public interest entity (PIE) is to firstly report on whether the financial statements on which the auditor offers an opinion deliver relevant, reliable and sufficient information to users of those statements and to secondly, where there is a shortcoming, remedy that shortcoming or, if it is not possible to do so, to report why that is and what its consequences are.

We thus align the purposes of accounting and audit in this statement. We think that essential if there is to be consistency in the approaches used by those engaged in the process of delivering true and fair financial statements.

Critically that alignment is based on meeting stakeholder information needs, which is why this Audit Briefing focuses upon what those needs might be. We think that the positive role that this definition gives the auditor as not just a person checking that

accounting standards have been complied with but in actively seeking to determine that the needs of users of financial statements have been met is a critical role for the auditor in the future.

As we then note having detailed what those information needs might be:

If any of the information needs referred to in this Audit Briefing are not at present met by the financial statements of public interest entities. This is not by chance. It is, in fact, completely deliberate. It is currently assumed (as is clear from the IFRS definition of the purpose of accounting) that PIEs, like all other accounting entities, only have consequence for a limited range of 'insiders' within the entity itself. These insiders include shareholders who can clearly be defined in this way since they are viewed as the owners of the entity. The result is that any broader responsibility of the PIE or consequence of its existence for other stakeholders is ignored during the accounting process as defined by IFRS. And, since audit is currently defined by audit regulators as being an activity that simply confirms that accounts have been prepared in compliance with an accounting framework like IFRS the audit also ignores the needs of most stakeholders as well.

It is our suggestion that this is wrong. As we have noted in our Audit Briefing on the definition of public interest entities, we are of the opinion that such entities always have macroeconomic impact and as such have inevitable consequence for those many stakeholders that they might engage with. This Audit Briefing seeks to broaden the understanding of both accounting and auditing so that those macroeconomic obligations might be addressed within the financial statements of all PIEs. We believe it is time that accounting standards reflected this need and that auditors were required to ensure that stakeholders receive all the information that they need from entities that have an impact upon them. As such we recommend that the disclosures noted in this Audit Briefing be required within the financial statements of all PIEs.

We are aware that the government is planning to [publish its audit reform agenda soon. We can hope that some of these issues might have been considered by them.