

August 16, 2019

Sir Donald Brydon
Brydon Review
Orchard 1, 1st Floor
Department for Business, Energy & Industrial Strategy
1 Victoria St
London SW1H 0ET
UNITED KINGDOM

Via email: brydonreview@beis.gov.uk

Re: Independent Review into the Quality and Effectiveness of Audit

Dear Sir Donald:

CFA Institute appreciates the opportunity to comment on the [*Independent Review into the Quality and Effectiveness of Audit Call for Views*](#) (Call for Views, Review, Brydon Review). We offer overall comments and responses to specific questions that we believe should be considered as a part of the Brydon Review as it pursues efforts to strengthen the quality and effectiveness of audit.

CFA Institute¹ is providing comments on the Call for Views consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

OVERARCHING CONSIDERATIONS

OUR AUDIT ADVOCACY EFFORTS ON BEHALF OF INVESTORS

CFA Institute has a long history of advocating for audit reforms globally including, most recently, reforms to enhance the auditor's report and to increase transparency regarding audit participants (e.g. disclosure of engagement partner names, audit tenures and affiliated firms). We have also advocated for audits of internal controls and auditor oversight reforms brought about by legislation such as the U.S. Sarbanes-Oxley Act of 2002 (SOX Act) and similar regulation globally. **Appendix A** provides a sample of our commentary in recent years.

¹ With offices in Charlottesville, New York, Washington D.C., Hong Kong, London, Brussels, Mumbai, Beijing and Abu Dhabi, CFA Institute is a global, not-for-profit professional association of more than 166,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 162 markets, of whom more than 160,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 74 markets.

INVESTING IS GLOBAL, AUDIT REFORMS HAVE GLOBAL IMPLICATIONS

While companies, and their auditors, follow accounting and auditing requirements in their country of domicile or registration, investors invest globally seeking comparative advantages – including advantages from jurisdictions with high-quality audits – in investment opportunities between jurisdictions. Accordingly, as an investor organization, we think about accounting and audit issues globally. Though we may respond locally to consultations, the conceptual principles that inform our positions are globally applicable as we view the audit market globally.

We believe it is important to comment on the Call for Views as audit reforms in the UK have an impact on other audit markets given the global nature of the listed public companies subject to audit and the interconnected and global nature of the largest accounting firms. We have evidenced the Brydon Review being a topic of discussion in forums outside the U.K. from the U.S. to Singapore.

VARIOUS UK AUDIT REFORMS

In our recent [comment letter to the UK Competition and Markets Authority \(CMA\) related to the Statutory Audit Service Market Study](#) we provide our views on the proposed remedies of the CMA against the backdrop of our most important concern – audit quality and enhanced transparency – and our consideration of whether the CMA’s proposed remedies improve outcomes for investors. We are not supportive of many of the CMA recommendations – other than regulatory oversight of audit committees – as we believe most are focused on increasing competition in the audit market amongst sellers without increasing transparency regarding audit quality to buyers of audit services (i.e. investors). From an investor perspective, more sellers in a market without transparency on audit quality to buyers will not improve the UK audit market. The aforementioned CMA comment letter should be read in conjunction with this letter as it also includes our views on improving audit quality – our primary concern.

Auditing is a business vested with the need to create trust and protect the public interest. The role of regulators in providing guardrails and overseeing audit quality is very important. For that reason, we believe any remedies emanating from this UK Government Independent Review regarding the Quality and Effectiveness of Audit (i.e. [Brydon Review](#) and the related [Call for Views](#)) must be tightly connected to and orchestrated with:

- the recommendations of the CMA related to the [Statutory Audit Service Market Study](#),
- the Independent Review of the Financial Reporting Council (i.e. [Kingman Review](#) and [Final Report](#)), and
- the [Business, Energy and Industrial Strategy \(BEIS\) Committee Inquiry](#), including its report on [The Future of Audit](#).

The results must be evaluated and orchestrated collectively. Investors want to understand better how such reviews are interconnected both in content and timing and how they will be brought forward in a prioritized, organized and cohesive fashion that results in improved audit quality.

AUDIT QUALITY: INVESTORS PRIMARY OBJECTIVE

We believe audit quality² is the single most important area that needs significant improvements both relating to the audit process and product and the related regulation. In our opinion, the collective goal of the reviews and reforms should be to ensure consistent high-quality audits. In our recent [comment letter to the UK Competition and Markets Authority \(CMA\) related to the Statutory Audit Service Market Study](#) we make the following comments about audit quality. We repeat here our concern as it is foundational to our views.

As an investor organization, we strongly support the efficient functioning of markets. Markets generally benefit from broad competition. Such competition should lead to value for money and increased quality. The Big 4 (PwC, EY, Deloitte and KPMG) represent a formidable oligopoly. However, for a market to be perfectly competitive³ not only does an efficient market need numerous buyers and sellers but they also need them to be well informed. In the current audit market, buyers of audit services – ultimately investors – do not have the information necessary to judge audit quality. The inability to observe audit quality is rightly mentioned within the Audit Market Study (e.g. Paragraph 2.4)

Investors' rely on agents or intermediaries (the audit committee) and the seller (the accounting firm) to protect their interests and ensure the performance of high quality audits. These intermediaries, however, have incentives that may run counter to the objective of protecting investors' interests. Audit committees may pressure auditors to lower price to engender themselves to company management and auditors may seek to ingratiate themselves with management by exercising less professional skepticism – or being less challenging of management's decisions – as well as reducing audit procedures and quality to retain audit engagements and enhance their profits. The simple reference to companies under audit by auditors as the "client" has the effect of connoting a dependent rather than independent relationship and confusing the fact that the ultimate client, or the buyer, is the investor. These incentives, combined with limited information and transparency regarding the audit from both audit committees and auditors, makes it even more challenging for investors (buyers) to judge quality. Further complicating the ability to judge audit quality, is that audit regulators also provide little detail when communicating to investors and the public more broadly about audit quality. As we note above, the intense media reaction can distort the narrative on audit quality. Investors and other stakeholders want to, and should, rely on communications from three principal sources for gaining an understanding of the quality of the audit. These are: 1) the audit committee, 2) the auditor's, and 3) the regulator. An efficient market requires more than simply a plentiful number of buyers and sellers, but for them to be well informed by those charged with protecting their interests. This is not the case in the audit market.

Official bodies engaged in audit standard-setting and enforcement (e.g., FRC, IAASB, PCAOB, etc.) have worked to adopt improvements – including those we have advocated for – in standard-setting over the last two decades. They have also worked to draw greater attention to the importance of audit quality by increasing the ability of auditors to pushback on "challenging clients." While these improvements are welcomed, regulatory inspection results over the last several years show that improvements – particularly in the communication from audit committees and auditors as well as from regulators are still needed. As we noted in our recent letter to the Public Company Accounting Oversight Board (PCAOB's) in relation to its Strategic Plan (2018-2022), investors have little transparency into the activities and findings of those charged with protecting their interests and that improvements continue to need to be made. Only recently have audit reports improved – recognizing that the UK market has lead the way in advancing some of these reforms. That said, as we recently advised the PCAOB, we have little insight into the severity of the regulators findings and how to gauge the quality of the auditors work and the regulators findings. As we note in our letter to the PCAOB we need more analysis, synthesis and contextualization of the regulators findings – not just in the US, but globally – to be able to gauge audit quality.

² As we note in our responses to Questions 4-6, we define the audit quality gap as the inability of current audit work to meet the current auditing standards rather than the gap in what the public may perceive as the auditors' responsibilities versus the actual responsibilities required by the auditing literature – what we label the misperception gap. What these questions (Questions 4-6) highlight is that a standard or uniform definition of audit quality needs to be developed. But as we highlight elsewhere herein, most stakeholders – certainly not investors, likely not audit committees, and possibly not even UK regulators – have sufficient information or statutory authority to judge audit quality and sanction poor audit quality.

³ The Oxford English Dictionary defines perfect competition as "the situation prevailing in a market in which buyers and sellers are so numerous and well informed that all elements of monopoly are absent and the market price of a commodity is beyond the control of individual buyers and sellers."

Presently, there is little to no competition on audit quality not only because it is challenging for everyone to judge, but because managements generally don't influence the audit committee to select the toughest or highest quality auditor. Further, many audit committees and investors select the Big 4 firms, because they have limited ability to ascertain audit quality and they use brand identity (e.g. Big 4) and herding behavior as a basis for their decision-making.

While the Audit Market Study more fully considers the importance of audit quality (Pages 31-40), the remedies – in our view – suggest the CMA is perhaps still too narrowly focused on increasing the number of market participants (i.e. sellers) without precise articulation regarding how increasing the number of sellers will result in improvements in the quality or price of audits. Our view is that the CMA's attention needs to be on how to improve quality and communication (transparency) to investors. We believe the CMA research has the potential to contribute toward this end goal by enhancing the information exchange between market participants. With more information, investors will be able to better judge the quality of the audit; the price paid for the audit; the effectiveness of the audit committee in overseeing the auditors from selection, risk assessment, performance of audit procedures and reporting of results; and the effectiveness of regulators. We, therefore, want to emphasize that more choice in the market that leads to more competition does not necessarily deliver better quality audits. We are concerned that more participants might actually create more competition based upon price rather than quality. Audit quality – not increasing the number of market participants – is top of mind for investors

As investors – who strongly support efficient markets – the audit market cannot operate efficiently when there is a lack of transparency on audit quality. We believe a capital markets solution with regulatory oversight of quality and disincentives is the solution. We also believe improvements in regulatory oversight by an audit regulator are an integral part of the equation in improving audit quality. We do not believe the remedies proposed here should be implemented without a clear linkage of the actions to the responsibilities of audit regulators. Our response to the remedies that follow are guided by whether they will enhance this information exchange, increase audit quality and are regulations which balance a free, but fair, market.

CURRENT ENVIRONMENT: PERCEPTION VS. REALITY

Also in our recent [comment letter to the UK Competition and Markets Authority \(CMA\) related to the Statutory Audit Service Market Study](#), we considered the impact the current environment has on these calls for audit reform. Given we think this has significance bearing with regard to the Brydon Review, we reiterate those comments below:

Recent business failures in the UK and the related media attention have, again, raised the question of audit quality. There has been much in the press that has inflamed the reaction of many stakeholders (e.g. investors, the question politicians, pension trustees, and the broader public). We certainly don't disagree that such business failures are problematic and create significant consequences for not only investors but other stakeholders to an organization. While extensively reported upon by the UK media, there is much reaction, but not significant analysis of the causes of such business failures and the degree to which audit failures, aggressive accounting, fraud or market conditions that resulted in liquidity issues contributed to the lack of timely recognition of such business failures.

Audits do not necessarily prevent business failures as business failures stem from a lack of cash resulting from liquidity issues that can manifest quickly. Additionally, audit failures are not necessarily indicative of underlying business issues. There is much in the press that seems to inappropriately conflate accounting, auditing and business failures. For example, the accounting for goodwill has drawn the attention of media outlets such as the Financial Times and Economist. The write-off of goodwill does not create business failures, business failures create the write-off of goodwill. While there certainly can be more timely recognition of such impairments, amortization of goodwill – as some of the articles suggest – will not resolve these business failures. Amortization of goodwill will only artificially improve ratios such as return on assets over the amortization period. Sophisticated investors (i.e. price makers) generally write-off goodwill long before management, understanding the moral hazard of management's assessment. The cash related to the generation of goodwill is long gone. We disagree with the notion, that some management's like to communicate, when experiencing a write-off, that goodwill is a non-cash write-off. Rather, it is recognition, and communication, that the cash previously exchanged was not well spent. We highlight the issue of goodwill not to debate the merits of the accounting for goodwill, but to highlight the media's flawed analysis of many of the accounting, auditing and business issues. In a similar vein, some have used this moment as an opportunity to reignite the debate regarding fair value accounting. This is a red herring. Financial statements are replete with estimates – even the accrual of payables is an estimate. To suggest the financial statements be stripped of estimates such as fair value will have the effect of making the financial statements substantially less meaningful to investors. Financial statements that are simply a compilation of historical transactions offer little value to investors in considering the future prospects of the entity. They also – particularly in an age of technological disruption where there is discussion of the ability to audit 100% of historical transactions – would leave little value for the auditors to provide to investors in the information value chain. That said, auditors need to be able to effectively challenge management's estimates and to communicate in the audit report the uncertainty in such estimates and the procedures they performed to gain reasonable assurance over them. This is what investors want. It is where the value of an audit is derived in the eyes of investors. The future of the audit profession is inextricably linked with the profession's ability to provide such assurance as historical transactions will – in the near future – be easily auditable by machines. Further, the Audit Market Study rightly references an expectations gap by the public regarding the nature of the auditors' responsibilities (e.g. responsibilities regarding fraud). This is something auditors and regulators need to better communicate to address the media distortion. While we recognize there is much to do to improve audit quality, regulators must be cautious to clearly define the issues and remedies. The remedies must address the root causes, and the responses must not be disproportionate given the sometimes-flawed analysis of the issues by the media and politicians. Said differently, blunt instrument regulations may not be the remedy to nuanced and complicated issues that gave rise to the business failures that have put the auditing profession squarely in the sights of politicians, regulators and audit. The current perception should not drive the reality of the reforms truly necessary to improve audit quality.

We reiterate the above because there are many instances in the Call for Views where the Brydon Review seems to seek public perceptions about the purpose, scope and users of financial statements and the related audits – rather than their actual purpose, scope and intended users. We believe it is essential to bifurcate current requirements from perceptions when evaluating responses to the questions included in the Call for Views. Auditors can't be held to account for insufficient standards or be the scapegoat for inaccurate or unrealistic expectations.

OVERALL PERSPECTIVES

OBSERVATIONS ON THE CALL FOR VIEWS

As we reviewed the Call for Views and responded to the questions, we made several overarching observations related to the Call for Views itself that we think are important to highlight. They include the following:

- 1) ***Understanding of Auditing Standards, Auditor Responsibilities and UK Law*** – Several questions presume a high degree of knowledge regarding auditors’ responsibilities, auditing standards and UK law (e.g. Questions 3, 6, 15, 29, 30, 36, 42). While we recognize the Call for Views provides a brief background to each section, the underlying technical nature of auditing standards and UK law – without a more detailed articulation of the current requirements – may act as a deterrent to responding to the Call for Views for those not in the auditing profession, specifically investors. It may also lead to inaccuracies or misperceptions of auditors’ responsibilities. Question 28 highlights the producer-led nature of the auditing profession. The ability to respond to the Calls for Views is impacted by the technical nature of the requirements in this producer-led profession. Said differently, the producer-led nature of the rules represents a barrier to responding for those not schooled in the art of auditing nomenclature. For more useful input from investors, it may be better to state the questions with specific reference to existing requirements in layman’s language.
- 2) ***Perceptions & Opinions vs. Analysis of Facts*** – Many questions seek perceptions or opinions on issues rather than responses based upon an analysis of facts (e.g. Questions 1-6). Seeking perceptions or opinions – when there clearly isn’t a consistent foundational understanding of the existing or underlying requirements of auditors – is likely to make the responses less decision-useful. It is also likely to make evaluating and interpreting the responses more challenging as the premise, or knowledge, upon which the responses are made is not consistent or fully understood. Further, we worry that this approach may actually widen, rather than narrow, the expectations gap or result in the Brydon Review not seeming to be responsive to expectations that may not be realistically framed.
- 3) ***Lack of Information to Provide Informed Opinion*** – Some questions solicit feedback on matters where there is a lack of transparency upon which stakeholders can make informed decisions and formulate informed positions. For example, the level of internal vs. external auditor responsibilities (Question 9) is an example of where there is no information provided upon which key stakeholders to the Call for Views can provide input as such allocation of responsibilities is not visible externally. A more critical example is the lack of communication or transparency on the nature of the audit and its quality. This makes evaluating audit quality (Chapters 5 and 7) nearly impossible for investors – those for whom the work is meant to serve. Other stakeholders – including audit committees – have limited ability to make informed opinions on audit quality. Audit committees, for example, do not review audit workpapers. This assessment of audit quality is based upon what auditors communicate to them. Only regulators have access to audit workpapers and insight into the quality of audit work – but their statute authority in the UK is far too limited. Auditors, or the auditing profession, themselves should not be left to judge audit quality – particularly in the current environment.
- 4) ***Broad and Vague*** – Certain of the questions are broad or the terminology is vague. Examples, include, the meaning and usage of the term “assurance” or “wider assurance” (Question 7) and the meaning of phrase “confidence in the entity” (Question 2). Broad or vague questions may impact the ability to obtain actionable feedback because all respondents may not have interpreted the questions in the same way or with the same understanding.

We highlight these considerations because, we believe it is essential to recognize these factors when evaluating the responses to the Calls for Views. These factors impact the perspectives, interpretations and understanding upon which the responses have been formulated and the degree to which they represent credible facts or substantiated opinions upon which policy decisions should be made. Overall, we encourage the Brydon Review to consider the nature of the questions and their inherent limitations or biases when evaluating the responses.

THEMES & NEED FOR PRIORITIZATION

We respond to the specific questions in the Call for Views in the next section. As we reviewed and responded to the questions, we noted, that there were overarching considerations to highlight with respect to the nature of the questions themselves and the ability to respond to them. We highlight those in the preceding section. We also noted, as we formulated our responses, that:

- there were themes implied within, as well as being explicitly articulated by, the questions;
- there were themes that ran across questions;
- many of the questions and themes were interconnected; and
- there is a need to prioritize the many topics or issues raised directly or indirectly via the Call for Views.

In **Appendix B**, we have attempted to collate and connect the topics and themes covered by the various questions in the Calls for Views. In this section, we have attempted to provide our perspectives on the explicit and implicit themes, how they are interconnected and then highlight investor priorities.

We think the Brydon Review must parse any policy recommendations into those that address immediate calls to improve audit quality (as we define audit quality) and those that are related to evolving the role of auditors. We see it as essential for the lawmakers and regulators to step back and make this analysis and prioritization – putting investors at the center of improvements in audit quality of publicly listed companies in the UK. This analysis and prioritization must be done across the various reform initiatives (Kingman, BEIS, CMA and Brydon) with clear communication regarding how these reforms will improve outcomes for investors.

We provide the following overall observations:

- 1) ***Audit's Intended Users (Investors) & Scope (Financial Statements)*** – Financial statements – and the accounting standards used as their basis of preparation – as well as the annual reports of publicly listed companies have investors as their primary and intended audience. The underlying information and its basis of preparation are based upon a target audience of investors (i.e. the intended users).

The fact that such information is public does not make it suitable to meet the objectives of all audiences (users). By extension, the audit of such information cannot be relied upon to assure such information is useful to all audiences (users). Each user group may have different information needs and standards may need to be developed – and audits separately undertaken – to meet such needs. Very simply, the public dissemination of audited financial statements does not change the intended use or users of such information.

As we consider the contents of the Call for Views, we think it is essential that policymakers remember the intended purpose and users of financial statements and not extend, or imply the extension of, the use of such financial statements or annual reports to such a wide group of users that it dilutes the value relevance of the information for investors. In this regard we are not simply referring to the inclusion of information in the annual report that meets the objectives of users that

investors can choose to ignore. Rather, we are referring to changing the nature and objective of information intended to meet the needs of investors for the purpose of other users.

We believe there is substantial education necessary regarding the purpose, scope and intended users of financial statements as well as current auditor responsibilities to resolve public misperceptions. Only after anchoring current perceptions to existing requirements through such education can there be analysis and discussion of how audit or assurance needs to evolve and whether such changes will resolve gaps in expectations.

- 2) ***Consistent Definition & Articulation of Expectations Gap*** – We believe there is a gap in expectations, but that the gap, or gaps, must be more precisely defined such that all stakeholders are referring to the same perceived problems. Misperceptions of the purpose and assurance provided by an audit (“misperceptions gap”) are different from gaps in the work performed by auditors relative to existing auditor or regulatory standards (“quality gap”). Further, expectations gaps related to audit may stem from misperceptions of the basis of preparation and intended users of the financial statements.

As the preceding paragraph highlights, we would define the gaps slightly differently than they have been defined in the Call for Views. We don’t define the quality gap to include the gap between what people expect of the auditor and what auditors are currently required to do under professional standards. This would be part of the misperception gap, as we define the gaps.

The inability of auditors to meet current requirements is our definition of the audit quality gap and is what the regulators and lawmakers must immediately address. Further, we are of the view that many perceptions of audit quality are based upon opinions – not an empirical analysis of the facts – as there is an insufficient communication (transmission) mechanism for buyers of audit services – or any stakeholders – to truly judge audit quality. Audit quality should not be judged based upon media accounts. For this reason, we believe a strong regulator to evaluate and communicate to investors the state of audit quality is an essential first step.

We also believe resolving the misperception or knowledge gap regarding the purpose and nature of assurance provided by an audit must be anchored in existing requirements with a path toward evolving accounting and auditing standards to meet such needs. This misperception gap requires a different, and possibly longer, path to resolution than addressing the quality gap.

- 3) ***Expansion of Auditor Responsibilities & Assurance*** –
- a. *Restoring Public Confidence is First Priority* – In our [comment letter to the CMA related to the Statutory Audit Service Market Study](#), we did not support auditor peer review because we do not believe a profession being publicly criticized for a lack of professional skepticism and audit quality – and with a public trust or confidence problem – should be entrusted with self-regulation. For the same reason, it seems inconsistent to expand or extend auditors’ responsibilities at the same time the purpose of this review as well as the CMA and Kingman reviews are being undertaken to address audit quality – not simply an expectation gap based upon a misunderstanding regarding auditor responsibilities. Our view is that repairing the public trust and confidence in the auditing profession must precede any expansion of auditors’ assurance responsibilities. It appears antithetical to seek expansion of auditors’ responsibilities before addressing current audit quality or execution issues.
 - b. *Ensure Consistent Definition of Assurance* – As it relates to the broader use of the term “assurance” in the Call for Views, we believe it is important that the Brydon Review be

precise in its definition of assurance and the technical nature of auditor assurance versus other forms of “assurance.” These broader definitions of assurance may not meet investors definition of assurance. Investors would define assurance as independent third party professional verification rather than management or director statements or assertions. The use of this term must be clear to not create a further expectations gap.

- c. *Clarify by Communicating Auditor Involvement* – As we note in our responses to the specific questions, and as rightly noted in the Call for Views (Paragraph 65), there is not a consistent understanding by investors regarding the level of auditor involvement and assurance on information contained within annual reports but outside the audited financial statements. This stems from the fact there is no explicit articulation of that involvement to investors. Rather, it is a matter articulated in the auditing literature. Unless investors are steeped in these technical auditing rules they do not have insight into the auditors’ involvement in or association with such information. From an investor perspective, we believe the degree of auditor involvement – wherever it occurs – needs to be explicitly stated for investors. Only with direct communication will there be a common understanding between auditors and investors on this other information.
 - d. *Auditor Involvement* – As it relates to auditor involvement and assurance over other (e.g. Non-GAAP, KPIs, ESG) information, investors have differing views on the degree of auditor involvement and assurance they want by type of information. Some investors want auditor involvement. Others see auditor involvement as a deterrent to management freely providing their perspectives. We highlight several illustrations of investors views on auditor involvement in other information from our member surveys in our response to Question 21.
 - e. *Analysis of Shareholders Wishes in Relation to Audit Scope* – We note the comment in Paragraph 134: *Finally, there is no clear analysis of the wishes of shareholders in relation to audit scope, even though currently the law makes clear the audit is carried out for their benefit.* We don’t share this view. **Appendix A** provides a plethora of examples of how investors have sought to communicate their audit needs to auditors. And the response to Question 21 provides views on auditors’ involvement in other types of information. Most recently, in 2018, we published a survey, [*2018 Audit Value, Quality and Priorities*](#). As such, we don’t believe the statement in Paragraph 134 is accurate.
 - f. *Cost vs. Benefit of Additional Auditor Involvement* – As to the cost/benefit analysis of additional assurance, investors have limited line of sight into the cost of assurance – as we highlight in our discussion of auditor fees. As such, making a cost/benefit analysis with respect to expanding assurance would require additional information – on the type of information, nature of assurance and cost – before investors could determine the value of such assurance.
- 4) ***Internal Control Certifications and Audits*** – The area where we are supportive of increased auditor involvement – because it relates to enhancing the quality of the work already performed – is in the area of attestation over internal controls. In the United States, we have found legislation such as the Sarbanes-Oxley Act of 2002 to be effective at increasing audit quality. Our experience has been that audits of internal controls combined with management/director certifications (both 302 and 404(a) certifications) are an essential element of the process of improving financial information. In our view, the behavioral changes (accountability and resource allocation) that emanate from the certifications are essential elements of improving the quality of financial information and the ability of auditors to execute their responsibilities. We believe management certifications – in addition to director certifications – are essential. Only management is close enough to the detail and engaged daily in the company’s processes and procedures to be able to

make such attestations and make sufficient resource allocations. See also Item 8 below regarding Responsibilities.

- 5) ***Stronger Regulator*** – We are very supportive of the results of the Kingman Review and the need for a stronger audit regulator with greater statutory authority who can create audit market quality improvements and overcome – to at least some degree – the payor model that disincentivizes auditors from acting on behalf of investors. While we understand this is not part of the Brydon Review, we think it is an essential element of improving audit quality in the UK and should go hand-in-hand with the expansion of audits of internal control. To our mind, a stronger regulator is an essential and immediate first step in improving audit quality. More effective communication from regulators (globally, not just in the UK) regarding audit quality and the sources, root causes and severity of audit exceptions noted by regulators is an integral element of the improvement regulators must make.

We do not believe the Review can consider the audit product irrespective of the delivery and regulatory mechanism⁴.

6) ***Auditor/Investor Communication & Audit Opinions*** –

- a. *Communication to Investors from Both Auditors and Audit Committees* – We have long supported increased communication between auditors (sellers) and investors (buyers). During the most recent round of audit reform, in the post financial crisis era, this has been a consistent message from investors to standard setters, regulators and other policymakers. While some companies and auditors have pushed for more communication to investors from the audit committee – in lieu of more information from auditors – CFA Institute members and investors broadly have clearly indicated they want to hear from both auditors and the audit committees. Both auditors and audit committees are charged with protecting investors interests and investors want to hear from both parties – separately.
- b. *Audit Opinion Revisions* –
- i. *Recent Reforms* – The most substantial change in the audit opinion globally over the last century has occurred since the 2009 Great Recession. The producer-led audit profession has been slow to change. It took the magnitude of the financial crisis to shift the reporting of auditors back to investors. Investors are the auditors' customer and investors need more information to judge the quality and value of the work performed. While auditors have been hesitant to increase what they say, the binary audit opinion and a lack of communication regarding the risks and uncertainties of the company under audit serve only to provide a false sense of precision to the audit and point estimates recognized in financial statements. We believe auditors must communicate more extensively to illustrate the judgement involved in management's decisions and their audit conclusions. The UK was the first to update and provide the most extensive enhancement to the auditor's report – but recent events in the UK highlight further enhancement may still be necessary.
- ii. *Technology's Impact on Audit Opinion* – In our response to Question 45 we also note that technological changes anticipated in the audit profession will change the value proposition of auditors. In our view, the real value of auditors in the future will come from their work on significant judgements, estimates and assumptions – rather than the audit of historical transactions, which may be heavily automated. To demonstrate this value, increased

⁴ See comment on Page 4 of the Call for Views.

communication on these areas of judgement is essential to establishing the auditors value proposition and the uncertainty involved in financial statements and the auditing process.

- iii. *A New Type of Modular Opinion* – In our response to Question 25, we highlight elements of an improved audit opinion that will address the concern investors have with the current audit opinion and how it must evolve with the technological evolution in auditing. As we outline in our response to Question 25 we propose an opinion based upon modules that address: 1) historical information; 2) internal controls and the control environment; 3) estimates, subjective data & technical complexities; and 4) non-financial statement data including analytical considerations
- iv. *Financial Reporting Must Evolve to Support* – We highlight in our responses to Questions 25 and 45, that an evolution in financial reporting and financial statement presentation must occur to improve the value relevance of financial reporting and the audits of financial statements. As we highlight there, we believe technology should be harnessed to improve the presentation and connectivity of the financial statements highlighting transactions that are based upon historical transactions separately from those that are based upon estimates and judgements. An improved statement of cash flow is essential and more sophisticated technology should be able to facilitate this.
- c. *Auditor/Investor Communication* – As it relates to ex ante and/or ex post communication with all users, this may be challenging to execute unless the intended users (investors) are defined as the primary audience. Without defining the intended audience engagement may be challenging.

Currently, there is great deal of information on an ex ante basis regarding what investors and/or analysts think of a company's prospects and areas of financial concern. We are not convinced auditors currently fully incorporate such information and perspectives into their analysis and audit procedures of a company. For example, substantial short positions on an audited company provide information content regarding the short-sellers thesis on a company's prospects. We do not believe auditors fully incorporate or refute the thinking and position of such stakeholders when considering the key audit risks, estimates or judgements of the company under audit. The same is true of analysts' reports on the company. Auditors do not seem to review such reports and consider the views of investors or analysts in the performance of their audit work. There is information to be gleaned from such analyses and positions. It is also important to remember that many buy-side, particularly hedge funds, will not freely communicate their views on a company to auditors given their propriety research or investment thesis and the timing of their position taking. Some investors actually derive alpha from the lack of financial transparency regarding a company and their ability to perform proprietary research.

On an ex post basis, a requirement for the auditors to have a physical report out to investors that is more extensive than currently required may be most important from a behavioral perspective. Such a report out may serve to act as an important behavioral, or symbolic, reminder that auditors ultimately are accountable to investors. For that reason alone, we believe this would be a useful undertaking.

- 7) ***Fees, Auditor Profitability and Value of the Audit*** – Investors have only the binary audit opinion (with discussion of key audit matters) and lump sum fees – in most jurisdictions – by which to judge audit quality and value of an audit for money. As we note in our recent [comment letter to the UK Competition and Markets Authority \(CMA\) related to the Statutory Audit Service Market Study](#), efforts to create greater competition in a market where there is an ineffective transmission of information from buyer to seller on the quality of the product being delivered will only serve to create greater competition to please management to gain further work and revenue for the firm. This creates a dynamic that will lower – rather than improve audit quality. We believe improved disclosure on the audit work performed – as noted above – and audit fees (e.g. breakdown of hours by audit areas, by audit team level, and by specialty), as well as audit firm profitability, will provide greater insight on the value and quality of the audit. The auditing profession is unique in that there is limited information to the customer on the product, the price of the product or the manufacturer.
- 8) ***Responsibilities*** – A theme which runs throughout the questions in the Call for Views is the nature and interrelationship between the responsibilities of management, directors and auditors. Much of the media attention has been focused on the auditors, but the directors and management have first line responsibility for the company. When it comes to internal control assessments, going concern assessments, viability statements, distributable reserves and fraud, we believe an overarching review or consideration of management and directors responsibilities must be made hand-in-hand with those of the auditors. The precise responsibilities of each group (management, directors, auditors) should be a subject of attention for the Brydon Review and the recommendations that are proposed. Said differently, is accountability appropriately identified and positioned with each party to the information value chain. In our view, management is not held sufficiently accountable for issues such as going concern, viability, fraud and internal controls. Expecting directors who have limited day-to-day direct engagement on these issues results in accountability at a level that is inconsistent with the knowledge of the details. We believe management combined with directors should have greater responsibility and accountability on key issues (e.g. certification of internal controls).
- 9) ***Auditor Liability*** –
- a. ***Liability Narrative Utilized to Limit Change & Innovation*** – Over the last decade, investors – in all jurisdictions – have experienced resistance to change on issues such as reforming the auditor’s report. Auditor liability has been expressed as one of the principal reasons to limit change. Our experience has been that this narrative is, many times, over emphasized as a reason to limit change. We have communicated with standard setters and regulators that they must be cognizant of this narrative being overstated as a reason not to move forward with reforms. Analysis of the narrative prior to the change and the actual outcomes subsequent to a change should be evaluated to establish or challenge the credibility of this narrative.
- In our view, the binary audit opinion actually creates a false sense of precision and may increase auditor liability because it portrays a false sense of accuracy. The binary opinion, in our view, also serves to limit investors perceived value of the audit and auditors as it commoditizes the auditors’ services and their product.
- b. ***Limitation of Auditor Liability Will Reduce Audit Quality*** – We do not believe liability should be limited or the independence requirement altered without consideration of the many other options related to reforming audit quality. Further, we are concerned that limitations in liability will decrease audit quality by allowing auditors to gauge their level of effort relative

to their potential exposure more precisely. Any recommendations to limit liability should be accompanied by a robust economic analysis considering the behavioral impacts of all stakeholders, including investors, to the audit process.

- 10) ***Technology & Innovation*** – Though some key improvements have been made, in the decade since the financial crisis, we have seen evidence of the challenge and time it takes to make substantial reforms in the audit market. As we note above, the implementation of technology may make the recently revised audit report in need of even further changes. As we note in our response to Question 45, our view is that technology will impact the business interests of the auditing firms. In turn, audit firms will work with auditing standard setters and regulators to evolve auditing standards. As it relates to accounting standard-setting, we see them moving more slowly than necessary to meet evolving investor information needs and the capabilities presented by technology. Currently, accounting standard setters are reticent to make accounting standard changes that preparers indicate will require technological change. This is clearly the case with financial statement presentation and segment data. Accounting standard setters do not seem to be willing to challenge or reconcile the ability of technology to be deployed so vastly in many aspects of our lives with preparers narrative that the technology is not possible to be deployed in financial reporting. Such an approach is making financial statements and standard setters substantially less value relevant and useful to investors. The audit can be no more relevant than the underlying information subject to audit. Accordingly, it puts pressure on the value relevance of audit. For example, the value of audit in the future will be derived from the ability of auditor to provide assurance on more forward-looking information rather than assurance on historical transactions that may be audited via technology. The accounting standard setters, unfortunately, are more engaged in incremental rather than strategic reforms in the information contained within financial statements.
- 11) ***Audits of Forward-Looking Information*** – CFA Institute has long supported more forward-looking information in financial statements as this makes the financial statements more relevant to investors. The Call for Views queries whether audits should be more forward-looking and seemingly doesn't recognize that the ability of an audit to be forward-looking is dependent upon whether the information subject to audit is forward-looking. An audit of historical information cannot, by definition, be forward-looking. As an investor organization that has long advocated for forward-looking information, we have experienced significant resistance to the desire for more forward-looking information. Accounting standard setters and auditors are generally more comfortable providing information based upon, and assurance over, historical transactions. Unfortunately, historical information is more confirmatory than predictive in value and investing is about discovering value or predicting future value. A better statement of cash flow would serve the confirmatory value of financial statements. While a balance sheet and income statement that includes current values and estimates, presented separately, would provide more predictive value. As we have communicated above, the value of the audit is a derivative of the value of the underlying information and forward-looking information is more valuable to investors. Auditors struggle with investors perspective that relevance of information is more important than reliability of information. Investors are willing to make a trade-off against reliability and toward relevance that auditors – understandably given their occupation and training – find hard to make.

As we highlight in the preceding sections, technology, innovation, the nature of the audit opinion and the value of the audit are inextricably linked to value of the underlying information and the evolution in information for investment decision-making. This should be a foundational consideration as a part of the Brydon Review.

- 12) ***Discrete Audit Topics for Separate Consideration*** – Topics such as auditors’ responsibilities regarding going concern, viability statements, distributable reserves and fraud – in our view – require separate consultation. These are special cases of the broader issues requiring separate consideration (i.e. misperception gap; audit quality gap sufficiency of accounting and auditing standards; communication; interrelationship of auditor, management and director responsibilities; etc.). We recognize the media accounts of high-profile corporate failures have drawn attention to these topics. That said, improvements in these areas require detailed analysis of the underlying information requirements or laws; management and director responsibilities; auditors’ responsibilities; and auditing standards rather than high-level opinions. For that reason, we recommend separate consideration of these topics. We make several additional observations as follows:
- a. *Going Concern* – We are not convinced that changing auditing standards related to going concern will solve the intractable behavioral incentives against going concern conclusions. To our mind better analysis of liquidity risks, better prioritization and disclosures of business risks and the involvement of those with industry analysis and valuation skills is necessary to improve the analysis. Given the historical nature of financial statements, the information set and skills necessary to evaluate going concern must be a key consideration in improving going concern assessments. We do, however, believe that requiring auditors to “show their work” would be a useful first step in improving auditors work and management’s responsibilities. We highlight other considerations in our specific response to Questions 15 and 16.
 - b. *Viability Statements* – We support research and analysis of the sufficiency of existing viability statements including how they connect to going concern assessments. We believe it is essential to balance and clarify auditors’ responsibilities relative to those of directors and management. We highlight other considerations in our specific response to Questions 17-19.
 - c. *Distributable Reserves* – We believe a review of the clarity and sufficiency of the legal requirements for distributable reserves is an essential first step. Included as a part of this review should be consideration of whether accounting records based upon IFRS should be the information set upon which distributable reserves are computed and whether the law has kept pace with the change in accounting standards. We highlight other considerations in our specific response to Questions 29-32.
 - d. *Fraud* – We are not convinced that requiring a fraud detection mindset or reasonable person standard is sufficient to improve the expectations users have of auditors as it relates to fraud. We do not believe the public has an accurate perception regarding the definition of fraud. Further, the public’s perception of the balance of auditors’ responsibilities with respect to detecting fraud versus management’s and director’s responsibilities with respect to preventing and detecting fraud seems out of balance. The nature and definition of fraud, controls to prevent and detect fraud and the nature of audit procedures related to fraud is an expansive topic. For that reason – and the fact that the public needs greater education on the topic – we think separate consultation and consideration of this issue is necessary before any conclusions can be reached. We highlight other considerations in our specific response to Questions 36-39.

13) ***Nature of Information Subject to Audit: Auditing & Accounting Standards*** – As we read the Call for Views and considered the questions, we observed that there was not an overarching recognition throughout the document that:

- a) information is created to meet the needs of a particular audience – not all users;
- b) information provided is based upon standards of preparation that serve the communication objective to the particular audience; and
- c) an audit cannot improve the communication objective or standards that are the basis of the information subject to audit.

For example, as we highlight above, an audit cannot be forward-looking without the information upon which the audit is based being forward-looking. Similarly, financial statement audits cannot ensure solvency if the information presented is not meant to meet a solvency objective.

The Brydon Review must consider not just the audit but the underlying communication objective and audience for the information. In doing so, the Review must also consider whether new accounting or other information standards must be developed for the preparation of information upon which auditors can execute an audit. In other words, it is not possible to reconsider the scope and purpose of auditors' responsibilities without considering the sufficiency of reporting standards for such information and the auditing standards applied to such information. While we note the Call for Views indicates it does not seek to address existing auditing standards per se, the review of auditor responsibilities related to going concern, and fraud, for example, are substantively about evaluating the sufficiency of auditing standards. Further, extension of auditors' responsibilities for other types of information, if recommended by the Review, must be accompanied by evaluating the sufficiency of the related auditing and accounting standards. Overall, it is not possible to reconsider the scope and purpose of auditors' responsibilities without considering the sufficiency of reporting standards for the information subject to audit and the auditing standards applied to such information.

14) ***Broader Auditor Responsibilities, Narrower Audit Firms:***

Will Audit Firms Have Expertise to Execute Against All Expectations? – As we considered collectively the expectations (actual or perceived) of auditors and the breadth of topics addressed in the Call for Views, an obvious question is whether auditors have the skills necessary to execute against all of these expectations. The Call for Views would suggest auditors' responsibilities should expand and include the following skills in addition to traditional auditing, accounting and financial reporting skills:

- More Extensive Company & Industry Knowledge
- Business Valuation & Liquidity Analysis Expertise
- Technology Skills (e.g. Data Analytics, Automated Auditing, etc.)
- Culture & Organizational Behavior Experience
- Other Information Standards Expertise (e.g. climate or human capital expertise related to ESG and industry metrics to support validation of KPIs and non-GAAP measures)
- Solvency (Prudential Regulation and Distributable Reserves) Experience
- Fraud Detection Expertise
- Legal Expertise

As we consider the variety of topics and perceived responsibilities of auditors, it seems antithetical that the other reform efforts (e.g. CMA) are focused on separating the non-audit service elements of the auditing firms from the audit practice while much of what is included in the Call for Views would expand the necessary expertise of auditors. As the Brydon Review is completed, we think it

is essential that consideration be given to the underlying subject matter expertise that is necessary to provide assurance over this broad set of perceived responsibilities and consider how the audit firms will recruit and retain the necessary talent to support assurance over this information. Providing assurance – particularly when dealing with future oriented, more subjective, or specialized information requires additional expertise beyond just accounting and auditing expertise.

SPECIFIC QUESTIONS

We respond to the 60 questions included in the Call for Views below.

CHAPTER 1: DEFINITION OF AUDIT AND ITS USERS

Q1: PURPOSE OF AUDIT: WHOSE BENEFIT & VALUE

For whose benefit should audit be conducted? How is it of value to users?

Technical Accounting and Auditing Literature – Accounting standards (e.g. IFRS) define in their conceptual framework the users of general purpose financial statements as investors and other creditors. Auditing standards define who the audit is meant to provide assurance to through the engagement letter and the addressee of the audit opinion. The UK independent auditors report states to whom the report is addressed (e.g. members) and the audit opinion language explains the opinion provides assurance as to compliance with IFRS, FRC requirements, and UK law (as applicable) in accordance with UK auditing standards.

Much of what has been written in the UK media implies a much broader set of users and stakeholders – and much broader assurance – than what the accounting, legal and auditing standards intend. We think part of the Brydon Review’s mission must be to facilitate education of the public regarding the difference between what the media implies is the scope and purpose of the audit and what the standards require with respect to the intended users of financial statements.

If public sentiment is such that the:

- a. information subject to audit (i.e. to meet the information needs of other stakeholders);
- b. related standards upon which this information is prepared
(i.e. accounting standards used to prepare financial statements); and
- c. auditors’ responsibilities;

must be broader than is currently required, then expansion and evolution of accounting/information standards and auditing standards will be necessary. This would be a substantial undertaking.

An Investor (Intended User) Perspective – CFA Institute has long advocated for the information needs of investors and the assurance investors need over such information. It would not be an overstatement to say that CFA Institute has been the most consistent, well-informed and vocal group representing the interests of investors, over the last 60+ year, as it relates to advocacy for information that is useful for investment decision-making. We have been at the forefront of some of the most significant – and controversial – requests for change in financial statements (information for investment decision-making). We have advocated for the recognition of pension obligations, fair value measurement of financial instruments, expensing of stock options, reform of audits of internal controls and audit opinions. As an investor organization, accounting and auditing standards are meant to serve our interests, yet investors generally have the least influence of all the stakeholders to the standard-setting processes.

Our advocacy positions are formulated from the perspective of a long-equity investor (i.e. residual owner of the business). We advocate from this position, as our view is that if the residual equity owners’ information needs have been met, then all other investor and creditor information needs should also have been met. As the residual equity holders, we are interested in the claims of these higher priority investors and creditors as they precede those of the common equity holders. As such, our information needs encompass their information needs. We do not believe that all other types of

users' needs are met by financial statements because financial statements are not designed with all such users in mind.

CFA Institute's information objective is to assist fundamental investors seeking to discover the intrinsic value of the business. We judge the quality of accounting principles based upon their ability to assist in this objective. Fair value, for example, is substantially more value relevant than the measurement of transactions at historical or amortized cost. While such measurements may be less reliable, they are substantially more relevant. That said, fair values are substantially harder to audit and audit evidence may be less precise. In this way, the accounting and auditing standards are connected in determining the value of the reported information – and the value of the audit – to investors. While auditing standards and audit procedures may provide greater assurance to investors on historical or amortized cost balances – because they can more reliably verified – the amounts subject to audit are not as value relevant. Hence the information, and the audit, is less valuable to investors. Said differently, investors find value in the audit, but the value of the audit is dependent upon the type and value relevance of the information subject to audit – and the ability of auditors to demonstrate skills in providing assurance that the more relevant, but likely less reliable measurements, are reasonable.

The issue with current auditing standards – and to a greater degree the audit report – is that it has not substantially evolved with the need for measurements that are more forward-looking (and relevant). The binary audit opinion gives a false sense of precision when it comes to the audit of forward-looking measurements. With historical cost measurements, for example, the audit was relatively easy – the measurement was either right or wrong based upon vouching to the amount paid plus or minus some amortization interpretation. With more subjective measurements and estimates, there are a range of possible outcomes around the amounts reflected in the financial statements. Management and the auditors need to explain the subjectivity of the work performed and the degree of assurance provided. While the key audit matters are a start, the underlying financial reporting also needs to be improved. We highlight this in our discussion of the audit report in Question 25. We would also note that the value of the audit is dependent upon the skills of auditors. These too need to evolve.

Other Users – There are, however, many other users of publicly listed company financial statements (e.g. prudential regulators, tax authorities, employees, environmental or social organizations, business partners, etc.) Each audience (user) has a different objective and hence may have different information needs. The financial statements, accounting standards, and the accompanying audit are not necessarily designed to accommodate such users' information needs.

As such, the information and the audit in the publicly listed company financial statements may or may not be valuable to them. The mere fact that the information is public may make other parties "users" but not – in our view – the intended users of the information and the audit. To our mind, financial statements are a medium of communication and may or may not be fit for purpose for every audience. The same is true for the audit. The audience and information needs are integral to the value of the information and the value of the audit.

Future of Information – In 2012, frustrated by a narrative of information overload we authored, [*Financial Reporting: Investor Perspectives on Transparency, Trust and Volume*](#), explaining that secular changes in technology and demands for new and different types of information (e.g. ESG, alternative performance measures, alternative data) made the then popular narrative of information overload a false narrative. Investors were not overloaded with information – they were seeking new and different types of information. In the time-period since then, we have seen broader recognition of

the role technology has to play in both the creation, provision and consumption of information. And, we have seen increased awareness of these new sources of information as relevant for investment decision-making. But many users are seeking information from financial statements for a purpose different than the intended purpose of the documents in which such information is contained. Many investors are also using information in documents other than annual reports (e.g. sustainability reports) without realizing the standards underpinning the preparation and the assurance over the information is very limited. The quality of such information can be spurious and the reliance by investors on such other types of information is an area of focus for our organization.

Overall – There are many different types of information needed by different types of stakeholders to a publicly listed company. In our view, the value of information and the value of the audit are correlated with the sufficiency of the underlying information to meet the users’ objectives. Likewise, the value of the audit is dependent upon the auditors’ ability to provide assurance on the information and explain, or report on, the value they bring to assuring its reasonableness. As it relates to financial statements of publicly listed companies, the intended user is the investor and the value of the audit should be tethered to this audience and their objective of obtaining decision-useful information for investment decision-making. Broader audiences may require different information and different standards of preparation. The Brydon Review must be cautious not to reduce the usefulness of information for investors while seeking to meet the information needs of a broader constituency of users. Central to any communication is an understanding of the audience and the communication objective.

Q2: PURPOSE OF AUDIT: ENHANCE USER CONFIDENCE IN ENTITY

Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?

The phrase “confidence of intended users in the entity” could be interpreted differently by different respondents to the Call for Views. The question also makes the distinction between intended users, whereas Question 1 simply notes users. Analysis of the responses should consider whether there was a consistent understanding and interpretation of this question.

In our view, the statement “confidence of intended users in the entity” means confidence in its financial prospects, including its solvency and financial viability, but it could mean confidence that it accurately presents its financial prospects – even if they are poor. In our view, the audit is designed to provide an opinion on the financial statements and whether they have been prepared in accordance with the accounting standards or regulations stated in the audit opinion in accordance with the auditing standards specified in the opinion. Any confidence beyond that would need to more precisely specified. As we discuss elsewhere herein audits do not provide assurance against business failures.

Q3: PURPOSE OF AUDIT: AMEND UK LAW

Should UK law be amended to provide greater clarity regarding the purpose of audit, and for whom it is conducted? If so, in what way?

Recent events in the UK have made it clear that there is not a precise understanding of the purpose or intended users of financial statements of listed companies nor the purpose of the associated audited. We are concerned that some of that public perception, or misunderstanding, has been driven by the media. Currently, from a broad public perception perspective, the answer to this question would seem to be yes. That said, this would be an opinion based upon a perception – not a detailed analysis of the facts and UK law.

General purpose financial statements prepared under IFRS – based upon the conceptual framework – are designed for the benefit of investors and other creditors. As such, an audit of IFRS financial statements – the information subject to audit – is for the purpose of investors and other creditors. As we note above, the information subject to audit is designed for a particular audience. Therefore, the information – not the audit – are primary in determining for whom the audit is conducted.

A more detailed analysis of the provisions of the applicable laws to the nature of the information currently being provided (and audited) and its currently intended users would appear necessary. Also necessary would be a gap analysis. This analysis would compare the current requirements with the nature of the information desired by a wider audience, the sufficiency of the standards used in the creation of that information set and the sufficiency of the auditing standards to provide assurance on such information. This would be necessary before any decision could be made regarding the need for a change in law to accommodate a more expansive set of users with different objectives and information needs.

CHAPTER 2 – THE ‘EXPECTATION GAP’

Q4: PURPOSE OF AUDIT: EXISTENCE OF EXPECTATION GAP

Do respondents consider there is an expectation gap?

Yes, we agree that there is an expectation gap, or expectation gaps. The questions throughout the Call for Views provide connotations as to these expectation gaps (e.g. responsibilities for detecting fraud; responsibility for preventing corporate failures; meeting information needs of all users not simply the intended users of the report; audit opinion in accordance with IFRS versus prudential requirements; lack of professional skepticism, etc.). However more precise definition and articulation of these gaps is necessary. The term “delivery gap” or “quality gap” as set forth in the Call for Views is not how we would define or label them.

The gap between what the public perceives to be the users, purpose and scope of audited financial statements under accounting standards and the related auditing standards and what it actually is under such accounting and auditing standards combined is what we would label as the “misperception gap.” We would not characterize this as a delivery gap as it implies the audit did not deliver on its requirements under legal or professional standards. The auditor was never required to deliver under these perceptions as such it is a misperception rather than a delivery gap or audit quality gap. To our mind the quality gap as defined in the Call for Views is that the auditing standards do not require assurance at the level the public may infer or perceive. For example, the public may perceive auditing standards on going concern or fraud ensure that the auditor guarantees an entity will remain a going concern or that an audit is designed to detect all fraud. This is likely a subset of the misperception gap, but one where auditing standards, public knowledge, and understanding of the audit need improving. We would not define this as an audit quality gap. Rather we would consider an audit quality gap as a gap between what is required of an audit and auditors under professional standards and what is actually performed. Said differently, the work performed in the execution of the audit was of poor quality and did not meet the existing professional or ethical standards of the auditing profession. This quality gap is something which must be remediated immediately. This quality gap is a justified public confidence/trust issue that must be addressed immediately and where a stronger regulator is needed to ensure compliance with existing standards. The other gaps are where work in standard-setting (auditing or accounting), regulations or other public policymaking – as well as education – are necessary. These are not audit execution issues or matters auditors should be held to account for unless standards evolve to require they address such issues.

We think the Brydon Review must be precise in how it defines these gaps as they require different public policy remedies. Further, we believe the Brydon Review has a responsibility to educate the public by anchoring the questions – and the Review – in the actual requirements of auditors and then asking how current audit requirements must evolve. In our view, the Call for Views questions – at times – conflate these issues. In doing so, the questions may possibly widen public misperceptions. It is also important for those conducting the Review to be cognizant of the difference between opinions or perceptions – for example as it relates to audit quality – and a response based upon an understanding and analysis of the facts.

Q5: PURPOSE OF AUDIT: NATURE OF EXPECTATION GAP

If so, how would respondents characterize that gap?

See response to Question 4.

Q6: NATURE OF AUDIT: DELIVERY OR QUALITY GAP

Is there also a significant ‘delivery’ or ‘quality’ gap between auditors’ existing responsibilities in law and auditing standards, and how those responsibilities are currently met?

In this question, the Call for Views seems to use the term “delivery” or “quality” gap to mean the execution of the audit relative to existing profession responsibility – our definition of the true audit quality gap. This is different than how it is defined elsewhere in the Call for Views where it is defined as difference between what professional standards require and what the public perceives an audit should require (i.e. our definition of the misperception gap).

As we highlight in our [comment letter to the CMA related to the Statutory Audit Service Market Study](#) there is an inability of buyers (i.e. investors) to gauge audit quality because they are given limited information on the work actually performed by the auditors, the results they achieved and the degree of precision applied. Today, investors – in most jurisdictions – only receive the audit opinion (i.e. albeit recently expanded) and the overall level of fees. Further, investors have limited information from regulators – as we outline in the aforementioned CMA comment letter and a recent [comment letter to the PCAOB on their strategic plan](#) – regarding regulator findings related to audit quality. As we have highlighted on many occasions, statistics on numbers of audit inspections findings appear quite high but the severity of such findings on the audit, and their correlation to financial statement failures, is not communicated in sufficient detail for investors to make meaningful assessments of these reported audit failures. High profile audit failures and high numbers of regulator deficiencies cannot be sufficiently contextualized to draw a precise conclusion on audit quality.

In our view, if investors can’t judge audit quality effectively, because the market has no transmission (communication) mechanism by which the buyers of audit services (investors) can make this judgment – and sellers of such services (auditors) are not capable of making an independent assessment of the quality of their work – then market forces will never operate effectively as there is no information exchange. Audit committees also aren’t experts in auditing standards and don’t review audit workpapers. As such, they too are not capable of making a quality assessment. In evaluating the responses to this question in the Call for Views, we would encourage the Brydon Review to evaluate whether those responding have sufficient facts to make a conclusion regarding audit quality – or whether their responses are simply perceptions. We support a stronger regulator who can make an independent fact-based assessment of audit quality – and who can provide an effective transmission (communication) mechanism to buyers (investors). As we note in our [comment letter to the CMA related to the Statutory Audit Service Market Study](#) the audit market is not an efficient market where buyers of audit services are well informed. As such, investors rely on intermediaries (i.e. audit committees and regulators) who are charged with ensuring audit quality, but who too do not communicate sufficiently regarding audit quality. This is why we have agreed with the CMA recommendation to create regulatory oversight of audit committees.

As it relates to the misperception gap – as we define it – the Brydon Review must anchor its recommendations in the existing audit requirements and define to what degree audits should – or can – evolve to meet, or narrow, the misperceptions regarding what audits are intended to accomplish.

CHAPTER 3 – AUDIT & WIDER ASSURANCE

Q7: AUDITS ROLE IN WIDER ASSURANCE

What should be the role of audit within wider assurance?

While the Call for Views provides the Oxford English definition of assurance, how respondents should interpret the term “wider assurance” and link it to what is already allowed under the auditing standards is subject to interpretation in responding to this question. Investors generally don’t view statements made by management or directors, as this section of the Call for Views seems to suggest, as assurance. Rather such statements are simply views of management or directors. When using the term assurance, investors generally associate this term with the involvement of an external third party that is independent of the entity. This independence and external perspective is essential to gauging the reliability of managements or directors’ statements.

We think audit – assuming investors can obtain better information on audit quality – has an important role to play in providing assurance to investors. That said, many investors do not have an understanding of the difference between audit and assurance and the precise degree of involvement that auditors have in the information provided outside the financial statements. The degree of association or assurance that auditors have with, or provide on, this other information is not clearly labeled as such. Many investors do not understand that information outside the financial statements is generally only read for inconsistency with the financial statements. The increased use of alternative performance measures (non-GAAP measures) in particular has alerted investors to the lack of auditor involvement with such other information.

As we illustrate in Question 21, investors have different views on the degree of assurance they seek on different types of information. Some investors want a high degree of assurance, other investors, do not want assurance – and certainly not audit – on certain information as they believe it will reduce management’s candor and reduce the behavioral insights they obtain management from such unaudited statements. The location and degree of legal liability that attaches to the information can also have bearing on the degree to which assurance is or isn’t sought by investors.

Overall, the type of assurance – as we define it – is dependent upon a variety of factors that are specific to the types and location of information. As stated, the question is very broad and needs to be narrowed to be able to respond more specifically. See also discussion at Questions 8, 21, 22, 25 and 54.

Q8: DIFFERING LEVELS OF ASSURANCE

Can a level of assurance that an audit provides legitimately vary in different circumstances, for example depending on the business sector in question, and the nature of the entity’s business risks?

The term audit implies a higher degree of assurance than does a review, for example. However, the term audit, in our view, is uniform in its definition across sectors and an entity’s business risks. It seems the real question being posed here is whether the ability of an audit procedure to meet the audit objective (completeness, existence, accuracy, valuation, ownership, and presentation) may have differing degrees of precision. The most vivid illustration of this relates to ability to audit measurements of assets and liabilities. As we note in our response to Question 2, investors like more relevant measurements like fair value, but auditors prefer measurements like amortized cost because the measurement can be vouched to the price of the historical transaction adjusted for amortization of premiums and discounts. Fair value measurements, on the other hand, require greater knowledge of the market the asset and liability trades within and/or the forward-looking assumptions used in the measurement. Hence there is more measurement uncertainty, audit uncertainty and risk. That said, the binary audit opinion – as we discuss in Question 2 and 25 – has not evolved to communicate the

degree of audit precision that can be asserted. In the view of investors, the lack of communication by management and auditors regarding the measurement uncertainty, and judgement and estimates made, actually puts the auditors at greater risk. Because the current communication connotes a higher degree of precision than actually exists, providing a more detailed explanation would be useful to be valuable to both auditors and investors.

Q9: EXTERNAL VS. INTERNAL AUDITORS: BOUNDARIES

Are the existing boundaries between internal and external audit clear?

Investors do not have line of sight into the work done by internal versus external audit. Investors expect that external auditors they engage to audit a company will take responsibility for, and reperform work as necessary, to ensure they can assume responsibility for any work performed by internal audit.

For investors to comment more specifically, they would need to know more precisely the nature of work performed by internal versus external audit.

Q10: EXTERNAL VS. INTERNAL AUDITORS: USE OF INTERNAL AUDITORS WORK

To what extent should external auditors be able to use evidence obtained from work performed by internal auditors in drawing conclusions?

See response to Question 9.

Q11: INDEPENDENCE OF AUDIT VS. INNOVATION & QUALITY

Do current eligibility requirements for external auditors focus too much on independence at the potential expense of market innovation and the quality of the audit product?

We do not view the requirement to maintain independence as correlated with or impacting market innovation or quality of the audit product. We see independence as a central tenant of the value of the audit. Ironically, despite all the independence requirements imposed on auditors, the existing payor model is, substantively, the biggest deterrent to auditors true independence.

We would need more information to assess the trade-offs being implied in the question.

We see audit quality as suffering because of a payor model than disincentives professional skepticism, lack of regulatory oversight and limited communication with the ultimate buyer of audit services – resulting in their inability to judge and seek improvements in audit quality.

See comments related to market innovation at Question 45. We generally experience an overemphasis on auditor liability--rather than independence--as the most significant deterrent to audit innovation.

See response to Questions 40-44.

CHAPTER 4 – THE SCOPE & PURPOSE OF AUDIT

OVERVIEW

Q12: DIRECTOR RESPONSIBILITIES: INTERNAL CONTROL & RISK MANAGEMENT

Should directors make a more explicit statement in respect of risk management and internal controls? If so, should such a statement be subject to audit?

We have long been supportive of the attestation over internal controls as required by Section 404 of the United States Sarbanes Oxley Act of 2002 (SOX 404). In particular, we have found the certification of internal controls by management (SOX Section 404(a)) – along with the attestation of disclosure controls and procedures required by SOX Section 302 – has been an effective behavioral change for management. These laws, which clearly place accountability (and legal liability) for internal controls over accounting and financial reporting with the principal officers of the company, have had the effect of increasing the resources necessary to enhance financial reporting. These certifications have had the effect of making upper management accountable for providing resources and attention to these important elements of financial management. We believe similar requirements should be implemented in the UK and, depending upon the respective laws, being attested to by management, directors or both as appropriate to UK law.

We are also supportive of the audit of internal controls as we believe it provides a higher degree of assurance and accountability by the auditor and ensures management takes their certification responsibilities seriously. In complex businesses, testing of – and confidence in – internal controls is an essential element of the audit. As such, reporting on the auditors internal control work is something investors have found useful.

Investors have also been supportive of SOX because it created the US audit regulator – the PCAOB. A stronger audit regulator who can evaluate audit quality and act as an incentive for auditors to exercise stronger professional skepticism, to mitigate the impacts of the current payor model, is something investors see as valuable.

As it relates to risk management, we would not be opposed to directors making a more explicit statement on risk management, but we would want similar information from management. It is not clear, however, the form this would take and the risks it would cover as there are a broad array of business risks to address. Whether auditors would have sufficient expertise to comment on the directors' statement regarding the risk management process, the risk management process itself or the indulging risks would need to be considered more fully.

Q13: AUDITOR RESPONSIBILITIES: INTERNAL CONTROLS

Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified?

See response to Question 12.

Q14: AUDIT OF INTERNAL CONTROLS

Auditors are currently required to report to audit committees their view on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?

We believe auditors should provide an audit opinion on the audit of internal controls – not simply a communication reflecting their views on internal controls tested as a part of the financial statement audit. See our response to Question 12.

GOING CONCERN

Q15: GOING CONCERN REGULATION FIT FOR PURPOSE

Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?

Following [the Sharman Inquiry](#) in 2013⁵, the FRC introduced changes to UK corporate governance and auditing standards. UK companies began being required to publish a strategic report, principal risks and a viability statement. The issue of going concern was also raised in 2013 by accounting standard setters at the [IFRS Interpretations Committee](#). The objective was to address the disclosure issue around going concern. However, the International Accounting Standards Board (IASB) decided not to make any changes [challenging the benefit of such disclosures and citing unintended consequences](#). The International Auditing and Assurance Standards Board's (IAASB's) standard on going concern, [ISA 570 Going Concern](#), was modified in June 2016 and the FRC is currently seeking input on revisions to its going concern guidance in the UK⁶. In 2012 and 2013 as the Public Company Accounting Oversight Board (PCAOB), Financial Accounting Standards Board (FASB) and IAASB reviewed the topic of going concern, CFA Institute completed a [member survey](#) on the topic of going concern. We also wrote a variety of blogs⁷ on the topic.

There is significant guidance for auditors, and companies, on the topic of going concern, yet the job of evaluating going concern seems most accurately made by investors rather than management, directors or auditors. The issue with the aforementioned guidance isn't the guidance itself but the incentives around those making such evaluation. Neither management, directors or auditors want to make an assessment that leads to a going concern. The market, however, has a mechanism for buying and selling the shares of a company allowing investors to act, and take a position, reflecting their assessments – not simply disclosing their assessment or taking a position that is counter to their interests. Ironically, many times management, directors and auditors fail to consider, or simply discount, the market's assessment of the company. For example, the increase in short positions or the work of activist investors. While insiders have substantially more information on the company than investors, routinely the company is the last to make the assessment regarding a question of going concern.

CFA Institute has a long-standing view that auditing standards that require auditors to raise and address the topic of going concern with management – without requiring an assessment of going concern first be the responsibility of management and the company's directors – is insufficient. Forcing auditors to address this potentially sensitive topic and challenging their "client" is something that is inconsistent with the current payor model. While this is not the case in the UK, where there is a requirement for the directors to make an assessment and auditors to evaluate the statement, the question is really one of

⁵ FRC Going Concern Guidance at time of Sharman Inquiry
<https://www.frc.org.uk/getattachment/54e711bb-c2aa-45d8-8a75-ef62a6acd95b/Going-concern-and-financial-reporting-issued-in-1994.pdf>

⁶ FRC Consultation on Going Concern
<https://www.frc.org.uk/getattachment/c6a969db-a720-4d69-87fa-1567e970ce24/;.aspx>

⁷ CFA Institute Going Concern Blogs
<https://blogs.cfainstitute.org/marketintegrity/2012/05/22/continued-concern-for-going-concern-reporting/>

<https://blogs.cfainstitute.org/marketintegrity/2013/10/09/going-concern-warnings-fewer-firms-improved-in-2012-and-its-impact-on-investors/>

<https://blogs.cfainstitute.org/marketintegrity/2013/07/01/investor-win-fasb-proposes-enhanced-going-concern-warnings-for-u-s-firms/>

sufficiency and specificity of the assessment and the moral hazard of management optimism as well as the impact of disclosure. For investors, an inability to continue as a going concern comes from the emergence of risks. Consistent assessments of the various risks faced by the company does not make the disclosures a self-fulfilling prophecy, they simply make all investors aware of the challenges faced by the company.

Many inaccurate going concern assessments come, in our view, from a lack of appropriate consideration of liquidity risks. These are the risks that make for quick and dramatic corporate collapses. Most auditors are challenged to precisely articulate the liquidity risks inherent in the company under audit. Evaluating liquidity risk is simply not a part of the routine audit process. As such, many auditors are not familiar with how to identify liquidity issues or make such an evaluation. Liquidity risk is, however, a risk keenly evaluated by investors. Additionally, investors – unlike auditors – are continually comparing the company under audit to their peers and assessing a company’s market and strategic position within the industry.

In our view, we are not convinced that further refinement of the governance, accounting and auditing guidance will change the incentives or behavior of those making the going concern assessments. We believe routine reporting on events or conditions that may cast significant doubt on an entity’s ability to continue as a going concern are helpful and, when a regular part of reporting, do not create a procyclical/self-fulfilling effect regarding going concern. Specifically, what investors would like is more robust disclosures on cash flows and the associated liquidity risks alongside an analysis of business risks prioritized by those that have the most significant impact on a company’s ability to continue in the short-term and longer-term. Investors would also like auditors and management to “show their work” in how they assessed liquidity and business risk and incorporated them into their assessment of going concern.

Investors understand these types of risk assessments and disclosures are subject to a high degree of uncertainty. What they are interested in is not necessarily the directors or auditors’ binary decision regarding an inability to continue as a going concern (i.e. because it rarely happens), but an assessment and prioritization of risks. From this, sophisticated investors (i.e. price makers) can make their own assessments and take appropriate market positions to reflect their assessments.

Q16: GOING CONCERN DISCLOSURES

Should there be greater transparency regarding identified “events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern”?

Yes. See response to Question 15.

VIABILITY

Q17: ADDITIONAL DIRECTOR DISCLOSURES

Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?

We do not perceive that investors understand, as accountants might, the technical difference between a going concern assessment and the viability statement as well as their intersectionality. Investors need more information and transparency regarding the objectives, constraints and inter-relationship of both assessments. Additionally, there is not a clear understanding by investors of the detailed nature of the auditors' responsibility for, or association with, each assessment, or statement. This should be explicitly stated for investors.

We agree with the view that an analysis of the sufficiency of current viability reports and the degree to which they go beyond boilerplate and consider changes or shifts over the long-term would be useful. Investors want a viability statement linked to the contents of the strategic report that assesses the sustainability of the entity's business model and long-term prospects (e.g. five years), articulates the risks associated with that assessment of sustainability and provides a perspective on how the business model may change over the next five years. Further, a retrospective assessment on the accuracy of information provided in previous viability reports would be decision-useful. Investors regularly use current disclosures to assess the reasonableness of a company's prior statements. Requiring management and directors to assess their previous viability assessments would be a useful exercise. Further, regulatory review and oversight of such viability statements on both a contemporaneous and ex-post basis would be useful in ensuring the integrity of their preparation and improvement over time.

Q18: ASSURANCE OVER VIABILITY STATEMENTS

Should such a statement be subject to assurance?

Over time, we have found investors to be of two minds on assurance over such types of forward-looking information, assessments and statements. Some investors argue that providing assurance will ensure that the company is realistic and fact-based in its assessment. Other investors indicate that they want the company to be allowed to speak freely and that engaging auditors may reduce the quality of the communication. These investors perceive they can – over time – assess management's behavior, truthfulness, candor and accuracy in making disclosures by judging the previous disclosures against the emergence of future results.

Some argue that auditors are not sufficiently qualified to provide assurance over such information as they do not have the same insight into the market in which the company operates. This view, however, simultaneously casts doubt upon the auditor's ability to reach audit conclusions regarding goodwill impairments, other estimates that include forward-looking information and going concern assessments more broadly. Certainly, as financial statements incorporate more forward-looking information auditor's skills need to evolve as do the related disclosures. See our discussion of this issue in Question 1 and 25.

Investors also need a more explicit articulation of the auditors' involvement in or association with information such as viability statements such that they understand the relative level of assurance – as compared to, for example, the financial statements.

Q19: CAPABILITY TO PROVIDE ASSURANCE OVER VIABILITY STATEMENTS

Who might be capable of giving such assurance?

See also response to Question 18. Auditors may have the assurance skills necessary to validate historical information, but they may lack the requisite industry, subject matter or market expertise to assess the reasonableness of the assumptions and analysis made in a viability statement. The lack of ability to make sufficient calls on going concern and recent corporate failures make it necessary for the Brydon Review to assess whether auditors have sufficient skill, and an appropriate incentive structure, to be capable of providing such assurance. The ability to provide assurance of this nature requires different skills than auditing historical information. It requires greater context and experience in a company's market. For that reason we believe individuals skilled in financial analysis, valuation and investment decision-making may be better skilled than accountants and auditors to execute this work. Auditors have expertise in verifying information to source documents but not in making critical assessments of future business performance and cash flow analysis. As our survey on verification of ESG factors in Question 21 highlights, investors are interested in verification from those skilled in the subject matter expertise of the underlying information.

Whoever undertakes such assurance, it is also important to define and communicate directly with investors the nature or degree of assurance being provided.

UNAUDITED INFORMATION

Q20: FORWARD-LOOKING AUDIT

Is there a case for more forward-looking audit? What would be the main benefits and risks?

We agree with the statement in the Call for Views (Paragraph 65) that states: “Often, the information influential to analysis and understanding is not subject to audit, nor even to lower level assurance.”

For an audit to be more forward-looking, the information contained within the financial statements must be forward-looking. For auditors to look forward, they need forward-looking measurements and disclosures. Because investors focus on the future prospects of an organization, CFA Institute has long advocated for more forward-looking information to be included in the financial statements. For example, in the debate over the fair value of financial instruments we [highlighted the relevance of fair value as the most appropriate measurement basis given it incorporates forward-looking information](#). In doing so, we have long been criticized for our “progressive views” on more relevant forward-looking information – despite our attempts to explain why such information is most influential to analysis.

Our responses to Questions 1, 18, 19 and 25 outline some of the challenges with making audit more forward-looking. In 2014 we published a paper, [Forward-Looking Information, A Necessary Consideration in the SEC’s Review on Disclosure Effectiveness: Investor Perspectives](#). Our objective was to counter the incorrect narrative that financial statements are not – and should not be – the province of forward-looking information. At the time, the U.S. Securities and Exchange Commission (SEC) and FASB were debating the inclusion of cash flow information related to financial instruments in the financial statements – in response to the need to improve financial instruments accounting. Those objecting to the inclusion of such informants indicated such forward-looking information belonged outside the financial statements. While the aforementioned paper is framed in a US context – because of the debate at the time and the use of the term forward-looking in the US securities law – this view permeates the accounting and auditing profession globally. In the US and other parts of the world, we have found that preparers, accounting standard setters and auditors believe forward-looking information belongs outside the financial statements because of the use of this term in US securities law. Many accountants and auditors fail to reconcile this narrative to the increasing prevalence of forward-looking estimates in the financial statements (e.g. fair value, stock options valuation, impairment, and soon to be insurance accounting, etc.).

This narrative and debate are applicable in the UK context as well. Investors – those interested in fundamental valuation – want more forward-looking (and better cash flow) information. Our experience is that most accountants and auditors have little contact with investors and, as a result, have limited understanding regarding how financial statements are used by investors. As such, accountants and auditors do not always understand that investors are more concerned with the future than the past. The reporting of past results provides confirmatory but not predictive value. This is a subject of constant tension in the construct of accounting standards – and therefore auditing standards. As we touch upon in our responses to Questions 25 and 45, for the audit to remain valuable the province of financial statements must go beyond the compilation of historical transactions using historical measurements and audited by machines. As we highlight in our response to Questions 1, 18, 25 and 45, auditors must become more comfortable with estimates, ranges and disclosures that highlight measurement uncertainty. Our response to Question 25 also highlights that financial statements need to be modified to provide information regarding historical and forward-looking measurements separately and provide more useful cash flow statements.

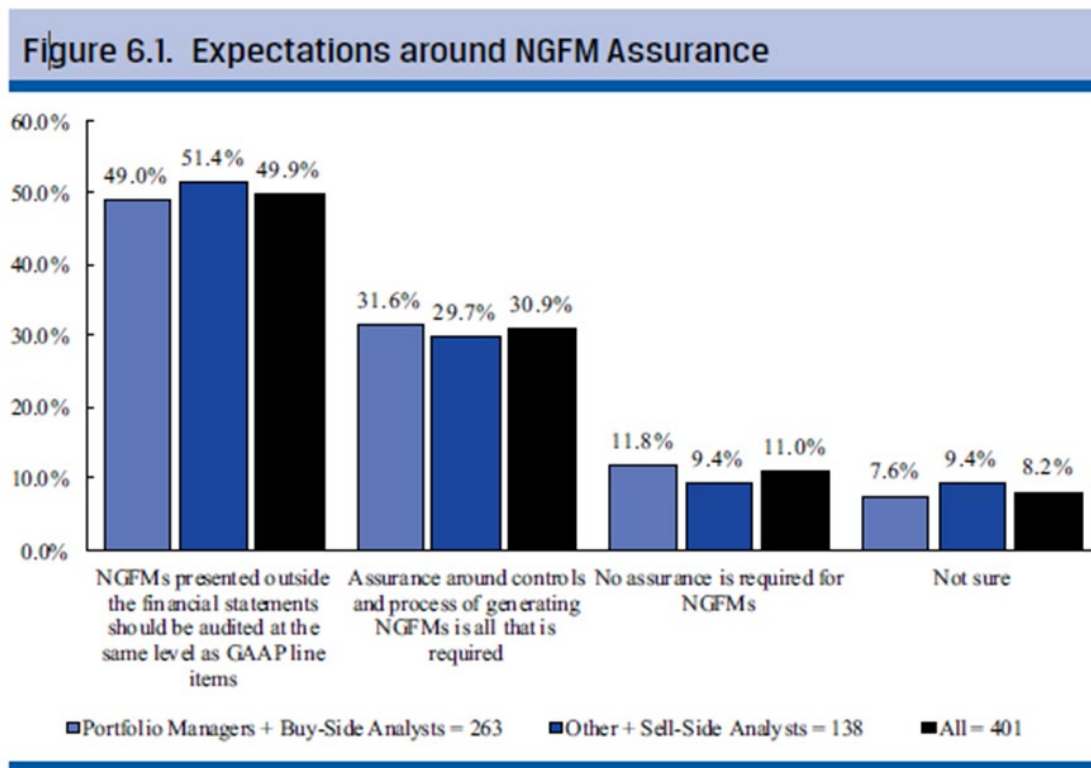
Q21: ASSURANCE OVER FINANCIAL & NON-FINANCIAL INFORMATION OUTSIDE FINANCIAL STATEMENTS: BENEFIT TO USERS

Would audit or assurance over financial and non-financial information outside the annual financial statements (for example KPIs or non-financial metrics, payment practices or half-yearly reports) enhance its reliability and therefore be of benefit to users?

Investor views vary on the issue of assurance over information contained outside of financial statements. We highlighted this debate in our response to Question 18. See also responses to Questions 7, 8 and 54.

Assurance over Alternative Performance & Non-GAAP Measures

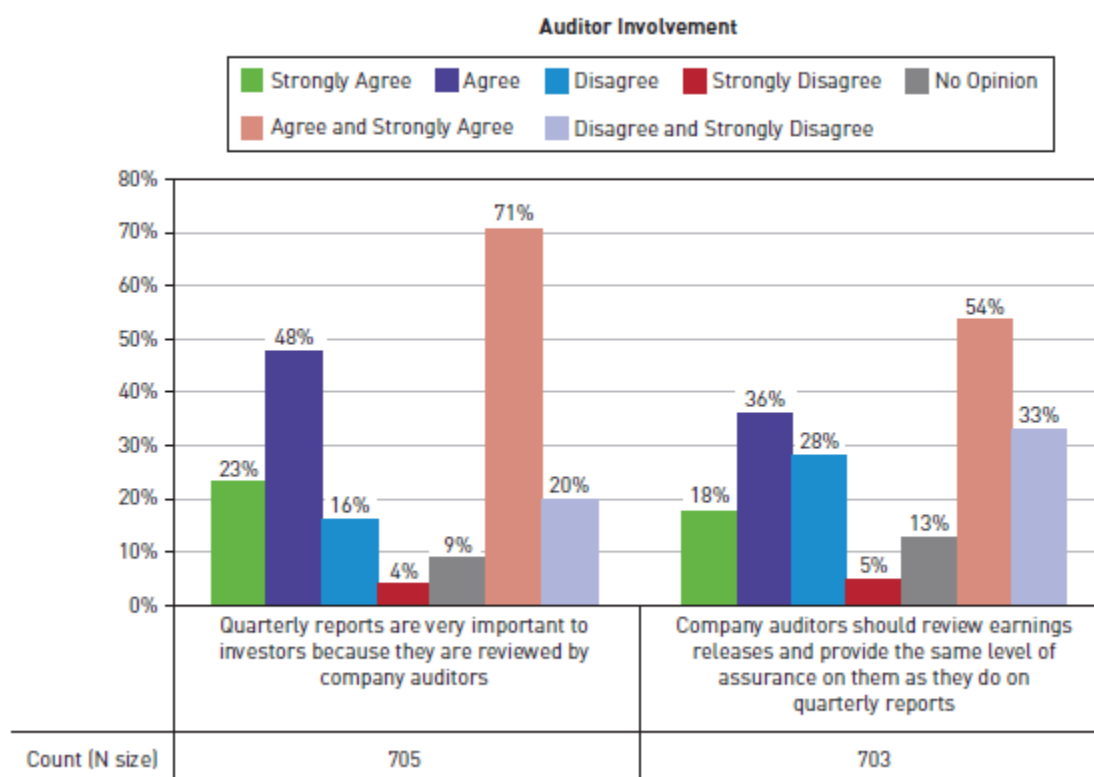
In 2016 we issued two papers related to alternative performance measures – [*Investor Uses, Expectations, and Concerns on Non-GAAP Financial Measures*](#) and [*Bridging the Gap: Ensuring Effective Non-GAAP and Performance Reporting*](#) – that included a member survey. One of the survey questions related to assurance over non-GAAP financial measures. See the chart excerpted from the publication below. The results of that question indicate that approximately 50% of all respondents wanted assurance (i.e. audit level) equivalent to that of the GAAP line items included in the financial statements while approximately 30% wanted assurance only over the controls and process of generating such measures.



Assurance over Interim Reporting

We recently issued a paper, [*The Case for Quarterly and Environmental, Social and Governance Reporting*](#). In it, we asked our members their views on assurance over interim information, including earnings releases. We found there was majority support for assurance over quarterly reports and earnings releases as shown in the following chart:

CHART 7:

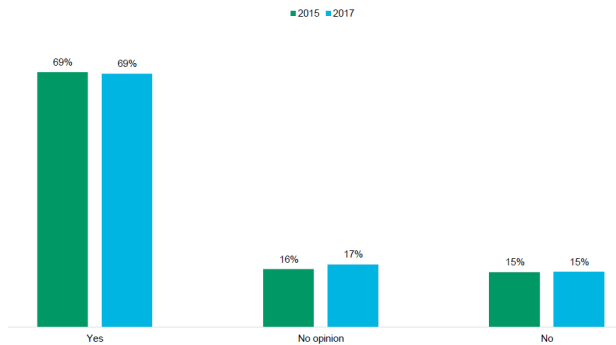


Several other questions in the aforementioned report address auditors association with earnings releases and interim information.

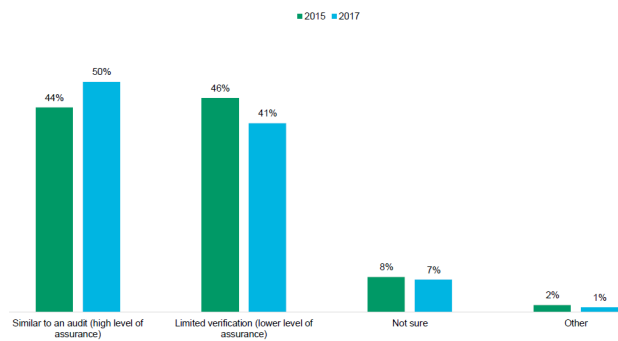
Assurance over ESG Information Factors

In [2015](#) and [2017](#) CFA Institute completed global member/investor surveys related to environmental, social and governance (ESG) information. As a part of the surveys, we inquired regarding the need for verification (assurance), the level of verification perceived as necessary, and who would be in the best position to provide such verification. The following charts highlight that investors believe some level of assurance is important but are split on whether it should be similar to an audit or more limited. Interestingly, more respondents felt professional services firms skilled in ESG were better positioned to provide that assurance than public accounting firms (auditors). This reflects a view that the nature of the underlying information extends beyond the core competency of accounting and auditing.

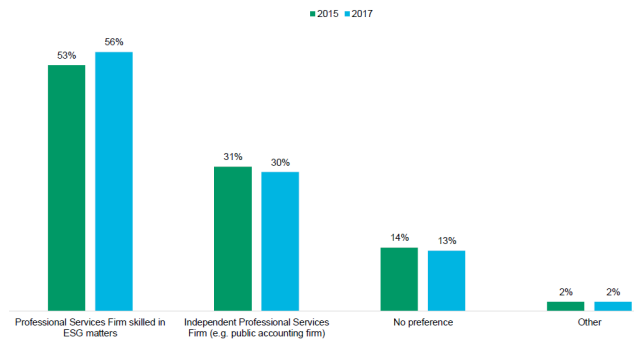
DO YOU THINK IT IS IMPORTANT THAT ESG DISCLOSURES BE SUBJECT TO SOME LEVEL OF INDEPENDENT VERIFICATION?



WHAT LEVEL OF INDEPENDENT VERIFICATION DO YOU BELIEVE IS NECESSARY?



WHO DO YOU THINK IS BEST POSITIONED TO PROVIDE INDEPENDENT VERIFICATION OF ESG DISCLOSURES?



Audit, Value & Quality Priorities

In 2018 we completed another member survey on [Audit Value, Quality and Priorities](#) the results of which are explained in the blog, [Audit Reform: What is the Optimal Way Forward](#). This survey also provides insights on the assurance over other types of information.

***Q22: ASSURANCE OVER FINANCIAL & NON-FINANCIAL INFORMATION
OUTSIDE FINANCIAL STATEMENTS: TYPE OF INFO & TYPES OF ASSURANCE***

If so, what information might usefully be subject to audit or another form of assurance and why?

We highlight in our response to Question 21 that the level of assurance varies by type of information. For each type of information, depending upon the nature of the information and its location (e.g. historical vs. forward-looking, quantitative vs. qualitative, financial vs. non-financial, GAAP vs. non-GAAP, within or outside financials, provided in other documents, and the associated legal protections) investors may have different responses. To be more specific in responding to this question each of the different types of information and where presented would need to be specified and we could survey investors on this issue.

We agree with the statement in the Call for Views (Paragraph 65) that states: “There may be confusion over which information disclosed by company has been subject to audit.” There is not a comprehensive understanding of the level of assurance – other than for the financial statements because it is generally not explicitly articulated for investors. Investors must understand auditing standards to appreciate the level of assurance. That is why we advocate for investors being provided with a communication regarding the nature of the assurance provided side-by-side with the related information. Investors should not have to understand auditing standards to determine the level of assurance provided given the information’s association with the financial statements.

CHAPTER 5 – AUDIT PRODUCT & QUALITY

Q23: VALUE OF AUDIT & AUDIT QUALITY VS. EFFECTIVENESS OF AUDIT PROCESS

Do respondents agree that the value and quality of the audit product should be considered separately from the effectiveness of the audit process?

Paragraph 70 of the Call for Views articulates two aspects of audit quality:

- 1) The quality of the auditors' performance against whichever standards or principles have been agreed, and
- 2) The quality of the audit output in meeting the legitimate demands of those for whom the auditors' report is intended.

In the context of publicly listed companies the auditors' report is addressed to, and intended for, investor members. This is why, as an investor organization, we have actively engaged in the development of auditing standards (as well as accounting standards) for decades. We believe it is essential that auditing standards must be developed – as should accounting standards – with meeting investor interests as a central object. The Call for Views in this question and others implies a wider group of users than the intended users of publicly listed accounts. We would refer you to our discussion in response to Questions 1-3 with respect the purpose and scope of the audit and Questions 4-5 with respect to the expectations gap. As we highlight there, we believe the perception gaps and audit quality gaps must be defined more precisely such that all stakeholders to this process and the Brydon Review are referring to the same perception, knowledge, quality or delivery gaps. As we define the audit quality gap, it only includes the first of the two aspects articulated above.

Paragraph 70 notes the Brydon review is focused only on the second element of the aforementioned quality gap. We believe this is insufficient and we believe the two elements are interconnected. We devote significant advocacy resources (as can be seen from **Appendix B**) in articulating the legitimate information needs of investors – those for whom audit reports are intended. But, investors do not have sufficient information to judge the sufficiency of audit quality with respect to the first element. We believe the most immediate and pressing concern should be the audit quality gap which we define as the first element of the aforementioned quality gap. The second element is fraught with knowledge and misperception gaps regarding the nature of an audit as well as the audience for whom the information is being published. In our view, there are a multitude of stakeholders and objectives that are being conflated.

This question refers to the effectiveness of the audit process but does not define precisely what this means. An effective audit is one that meets the object of providing sufficient evidence to reach the audit opinion. An audit opinion and an effective audit cannot meet expectations not set forth in auditing standards. As such, we presume this question is referring to the first element of the audit quality definition in Paragraph 70. It appears from review of Paragraph 71 that professional skepticism is not considered to be a part of the auditing standards and, hence, an effective audit. Paragraph 71 implies that an effective audit is simply a compliance exercise without the exercise of judgement and professional skepticism. We disagree with this assertion. For that reason, we do not believe the value and quality of an audit can be separated from the effectiveness of the audit process. The legitimate demands of the intended users must be incorporated into the information standards of the information subject to audit and the auditing standards applied to such information.

Overall, we don't see it possible to separately consider the need for the audit product to evolve from the quality of the audit process today. If investors don't have confidence in the ability of auditors to

deliver against existing standards, then how can extending auditors work – potentially to more challenging types of information – be sensible. Confidence in audit quality – as we define it (and as defined as the first element in Paragraph 70 – must be improved before entrusting auditors with more responsibility. Investors also need to understand whether auditors have the requisite skills to provide assurance on broader and more complex types of information (e.g. ESG, valuation and going concern) that may be outside of their core accounting expertise.

That said, as we highlight in our response to Question 1, the accounting and auditing standard-setting process does not always work in the short-run to serve investors needs given the politics of the standard setting process. We believe moments such as this one in the UK are important to evolving the auditing process to meeting the needs of investors in the long-term. If there are legitimate needs from investors to improve audit quality or the purpose and scope of audit to meet investors needs they should be undertaken.

Q24: AUDIT EFFECTIVENESS VS AUDIT TIMELINESS

Do respondents consider that emphasis placed by auditors on ‘completing the audit file’ for subsequent FRC inspection can eclipse the desired focus on matters requiring the exercise of considered judgement?

We respect that there are significant time pressures on auditors and that completing documentation of such procedures can be time consuming and challenging under the pressures of company deadlines. That said, unless audit work is documented there is no evidence that it occurred and without evidence of audit procedures they can’t be said to have been completed. Said differently, the judgement of auditors cannot be evaluated and demonstrated without completing the audit file. We think auditors and clients need to work to allow auditors sufficient time to complete deliverables. If auditors are operating with unrealistic time tables because of the timeliness of client deliverables, then this should be discussed with the audit committee and the audit committee should respond with additional resources or additional time. If the reason for the inability to complete the audit file in a timely manner stems from a lack of auditor resource, then the audit firm – not simply the individual engagement partner – should have a process to ensure sufficient resources are devoted to the engagement. If auditors perceive their professional judgment is being impaired by resource constraints in documenting their work, they should be able to elevate such concerns to the audit committee of the company or the audit firm’s internal quality control processes without fear of retribution.

Overall, completion of the audit file for FRC review should not trump the completion of high quality audit procedures, but the firms should critically evaluate engagements to ensure audit teams have sufficient resource (time, expertise, etc.) to meet the objective of a high-quality audit as evidenced in the audit file. This is something we have asked audit regulators to consider as part of a root cause analysis.

BINARY NATURE OF AUDIT

Q25: AUDIT OPINION: BINARY VS. GRADUATED

What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?

CFA Institute has been a key advocate for audit report reforms. Our numerous investor surveys ([2008](#), [2010](#), [2011](#) and [2012](#)) showed that investors wanted more information from auditors regarding their work. We communicated such findings to the IAASB, FRC and PCAOB during their development of the new auditor's reporting models. We expand on this in Question 51 as a part of the discussion of shareholders' use of the audit report. We also highlight in Question 45 the evolving role of technology in the audit report. In the decade the revised audit report has been under development, technology has shifted. In our view, the future value proposition of the audit – and the nature and content of the newly revised audit opinion – is in the process of evolving. In other words, the new audit opinion may already need reform.

While there is much discussion regarding how technology will change the audit process, audit procedures and auditing standards, there has been little conversation, in our view, regarding how the audit report – the output of a potentially new audit process – will need to evolve. With automated verification of historical transactions, auditors' time – and the value they bring to the information integrity ecosystem – should turn to the more subjective estimates included in the financial statements. Without an ability to provide improved assurance on these estimates, investors may question the value and price paid for a technology-based audit of historical transactions.

With the ability to verify transactions completely, investors will want to know what types and quantities of transactions were 100% verified and what were the auditors' areas of focus and judgement beyond these transactions. The use of technology will also have a significant impact on the audit of internal controls – changing and possibly reducing the controls tested – as transactions are 100% verified. Still further, technology holds the promise of auditors being able to use external data about their clients to validate their knowledge of the client through more than just risk assessments. As we note in our discussion of auditors' responsibilities related to going concern and viability in Questions 15-19, such information will provide them with greater context for their audit opinion and the market's perception of their conclusions.

As we note in Question 22, we find that investors have varying degrees of knowledge regarding the level of assurance over information contained outside the financial statements. There are many misperceptions regarding the responsibilities auditors have over information contained within annual reports and registration statements outside of the information confirmed within the audited financial statements. Generally, our view is that many investors perceive there to be a higher level of assurance over information contained outside the financial statements than there is in reality. We think it is important to clearly communicate – within such registration statements and annual reports – the work completed by the auditor on these areas in addition to providing an opinion on the financial statements. The nature of this work must be articulated explicitly in an opinion or statement that precedes the information such that it is clearly labeled for investors.

In our view, a more detailed or graduated approach or communication regarding the work performed would be most useful to investors in an evolving audit marketplace. Communication regarding the differing elements of the audit – one based upon the nature of the procedures performed and the inherent differences in the amounts reflected in the financial statements – would be most useful. For

simplicity, we will refer to this as a modular approach to an audit. We believe any audit – and the relate report – would include four main areas:

1. Historical Data – A basic binary opinion on the audit of historical transactions and related disclosures. This would be the highest level of assurance and leverage technology. The opinion could communicate the degree to which such historical data is audited leveraging technology and the degree to which transactions were 100% tested.
2. Internal Controls and Control Environment – An opinion on the audit of internal controls with identification of potential areas for internal control improvement. This would be a level of assurance consistent with current audits of internal control but would indicate that assessments of internal control failures are harder to quantify given the potential for error should controls fail.
3. Estimates, Subjective Data & Technical Complexities – An audit opinion on significant estimates, judgements and assumptions included on amounts or transactions reflected within financial statements (e.g. an opinion on technical matters) along with related disclosures. Investors would like more information on the estimates, judgements and challenging applications of technical literature and they would like more than point estimates of such information. This opinion would provide more quantitative and qualitative disclosures regarding the most judgmental information included within the financial statements. It would better contextualize and link the discussion to the elements of the financial statements. It would also articulate the degree to which subject matter experts were used. The purpose of this opinion would be to provide investors with a sense of the measurement or technical uncertainty and judgement involved in the audit. By its nature this precision of the assurance would be more limited given the underlying uncertainty of the balances subject to such audit procedures.
4. Non-Financial Statement Data – An opinion – likely with less assurance than an audit opinion – on the accuracy and reasonableness of information contained within other parts of the annual report (e.g. non-GAAP measures, ESG information, forward-looking information, management commentary, viability statements, strategic reports etc.). This would be an analytical opinion and would likely require subject matter expertise in the industry. Unlike today, this would be an explicitly articulated level of assurance rather than an implied level of assurance (i.e. reading for inconsistencies). The nature of the assurance would be dependent upon investors interest in such level of assurance.

Overall, our suggested approach would be graduated both in the types of opinions (e.g. historical, internal control, technical, and analytical) but within the technical and analytical we would expect more graduated disclosures and discussions of the auditors' procedures and results.

This approach actually bodes well with the reporting framework we outline in our 2007 publication, [*Comprehensive Business Reporting Model*](#). In that document we call for an improved statement of cash flows, an income statement that parses historical amounts from changes in estimates and judgements and it requires improved cohesion of the balance sheet to the statement of cash flows and income statement such that investors can link transactions between the basic financial statements. And, as we outline in our response to Question 45 on technology, we think technology should be more rapidly being incorporated into the strategic objectives of the accounting standard setters to facilitate this change. In our 2013 report, [*Financial Reporting Disclosures: Investor Perspective on Transparency, Trust and Volume*](#), we noted that we see vast improvements in information delivery, tracking and monitoring of transactions in all aspects of our daily lives, but we have yet to see that implemented in the financial reporting ecosystem. Further, we don't see standard setters actively

rebutting the narrative that accounting standards are “too costly” with the strategic advances in technology. Overall, we don’t see technology being implemented fast enough in the accounting and reporting space and this impedes progress on the auditing front. The use and availability of data for accounting and auditing should mean greater ability to provide data and disclosures to investors.

Q26: AUDIT OPINION: FURTHER NARRATIVE

Could further narrative be disclosed alongside the opinion to provide more informative insights?

See response to Question 25.

Q27: AUDIT OPINION: PREVENTING BOILERPLATE

What would prevent such disclosures becoming boiler plated?

If done correctly, it would be nearly impossible for the technical or analytical opinion to become boilerplate as they would be linked to changing elements of the financial statements. That said, there has to be more active oversight of auditors to ensure that audit opinion language reflects the content of audit workpapers and that there is an updating of issues from one year to the next. Regulatory oversight will need to be continuous.

Q28: AUDIT INNOVATION LIMITATIONS

To what extent, if any, has producer-led audit (including standard-setting) inhibited innovation and development for the benefit of users?

While CFA Institute teaches financial reporting and analysis as a part of the CFA Program, accounting – and even more so, auditing – is a highly technical language that investors don’t utilize on a daily basis to the degree that auditors and preparers do. As such, investors rely on organizations such as ours to translate the accounting or auditing parlance into the analytical impacts to investors. That is why – as we note in the introductory section on Overarching Considerations – CFA Institute has advocated for investor positions in the accounting and auditing standard setting process for over 60 years. We believe it is essential that investors – those for whom the information is meant to serve – provide their input. In recent years, the IAASB, FRC and PCAOB have actively engaged with our organization – as has the IASB. We are generally one of only a handful of investors contributing regularly to this process. We use member surveys and direct outreach to illustrate investor perspectives as we are generally the minority view – despite being representatives of those for whom the process is designed to serve, and showing investors consensus in support of our views.

We have seen the perceived minority investor view be disregarded because the preparer and auditor community are both more skilled in the technical parlance, more uniform in their views, more directly engaged and more in control of the audit standard-setting process. Our experience would suggest that the producer-led audit industry has inhibited the advancement of investors audit needs. In our comment letter last year to the Monitoring Group related to the consultation, [*Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Board in the Public Interest*](#), we highlight similar sentiments.

In the long-run, we have found market crisis bring focus to the real needs of investors. The current reform efforts in the UK represent an opportunity for standard setters, lawmakers, and regulators to demonstrate their commitment to protecting investor interests.

CHAPTER 6: LEGAL RESPONSIBILITIES

Q29: AUDITOR ROLE: COMPLIANCE WITH LAWS & REGULATIONS

What role should auditors play in determining whether the directors are complying with relevant laws and regulations, including with respect to matters of capital maintenance? Is it appropriate to distinguish between matters which may materially affect the financial statements and other matters?

The Call for Views raises the question of auditor responsibility for relevant laws and regulations in the context of auditors reviewing the work of directors as it applies to the directors' approval of dividends and the concept of distributable reserves. This question appears to reframe the consultation discussion to be even broader – so broad as to be challenging to answer. The scope of an auditor's work must, in practicality, be defined and limited to work related to financial statements or no auditor would undertake audit work. The question seems to imply that auditors' work should not only extend to the company under audit and its management, but the board of directors who hires them as well as to the many different aspects of corporate governance the board of directors is responsible for, or even broader. Auditors can't be responsible for compliance with all laws and regulations applicable to the board of directors of the company as this would be wider than their scope and their expertise (as accountants not lawyers). Further, the question does not distinguish between whether auditors should have an affirmative responsibility to test for legal violations (and under what type of laws) or whether they simply have a duty to report should they note legal violations in the performance of their audit procedures. It is also not clear who a violation of law by the board of directors would be reported to. As we note in the overall comments, this question is an illustration of a question in the Call for Views that may perpetuate an expectation gap and may be too broad to gain responses that are actionable for investors.

As it relates to capital maintenance we would make several observations:

- 1) Capital maintenance relates to solvency and should not be conflated with the purpose of accounting standards which are to reflect the financial position and performance of a company in accordance with accounting standards whose principal users are investors seeking decision-useful information for investment decision-making (i.e. valuation) – not assessing solvency or capital maintenance of a company.
- 2) Audit opinions make reference to compliance with accounting standards, not capital maintenance requirements. While capital maintenance and solvency rules are certainly important to investors, they are generally perceived by investors to be covered by different standards and audits.
- 3) Capital maintenance falls under prudential regulation not accounting standards.
- 4) The question of distributable reserves and auditors' responsibilities highlights the point we make in responding to Questions 1-3 regarding the intended audience and use of accounting information and whether the underlying standards (i.e. IFRS), and by association the audit, are fit for the intended use – computing distributable reserves.
- 5) We are supportive of disclosures of computations and capital maintenance levels such that investors and other stakeholders can make their own assessments as to the methods of computation and their adequacy.
- 6) We believe a separate consultation to solicit comments regarding the guidance on distributable reserves is necessary. Items to consider include:
 - a. Whether the capital maintenance requirements are sufficient, understandable and can be applied in practice. We understand the current guidance is vague from both a legal and accounting perspective.

- b. Whether distributable reserves should be computed based upon accounting information prepared under IFRS or whether there should be a separate basis of preparation (e.g. regulatory filings).
- c. Whether the computation of distributable reserves should have, but has not, evolved given the inclusion of more uncertain measurements such as fair value in IFRS financial statements. Said differently, has the evolution in accounting standards resulted in an evolution of distributable reserves or has the underlying data evolved such that it is no longer fit for the purpose of computing solvency? For example, legislative changes need to be passed to clearly define what is “realised” and “unrealised” both in terms of measurement and timing in determination of capital maintenance requirements.
- d. Whether the need for a more forward-looking audit – and hence more forward-looking information in financial statements – is consistent with information needed for computation of distributable reserves. Given distributable reserves focus on “realised” profits and cash collected from historical transactions, financial statements including forward-looking information may not be decision-useful in determine distributable reserves.
- e. Whether it is possible for one information set, such as financial statements, to be sufficiently forward-looking to provide insight on going concern and simultaneously not allow distribution of profits net yet collected.
- f. What are the precise responsibilities of management, directors and auditors with respect to the verification of distributable reserves.
- g. Whether auditors are sufficiently independent to audit the work of those who engage them (i.e. directors).

Q30: DISTRIBUTABLE RESERVES AUDITOR EXPECTATIONS

Does a perceived inconsistency between company law and accounting standards as regards distributable reserves inhibit auditors from meeting public expectations? How might greater clarity be achieved?

Yes. As we note in response to Question 29, we believe a separate consultation on this topic is required.

Q31: DISTRIBUTABLE RESERVES: DISCLOSURES

Should distributable and non-distributable reserves be required to be disclosed in the audited financial statements?

We believe distributable and non-distributable reserves should be disclosed in audited financial statements. Transparency regarding the computations will lead to market best practices, market discipline, and accountability.

Q32: ACCOUNTING RECORDS: AUDITOR OBLIGATIONS

How do auditors discharge their obligations relating to whether the entity has kept adequate accounting records? Are the existing statutory requirements effective in setting the bar for auditors at a high enough level?

We agree with the comments in Paragraph 95 of the Call for Views, where it is noted that Sir John Kingman recommended that accountability for adequate accounting records, compliant corporate reports and true and fair accounts should be the responsibility of the CEO, CFO, chair and audit committee chair. While directors can have ultimate accountability for accounting records there must be responsibility and accountability by key members of company management as they have day-to-day oversight, greater involvement in the routine operations and responsibility for personnel assigned in pursuit of this objective. We perceive one of the biggest benefits of SOX has been increased accountability and the resulting behavioral change of company management. This behavioral change (i.e. increased accountability and liability) has provided financial reporting personnel within the company, and audit committees, with leverage to garner resources to improve financial reporting records.

As it relates to auditors, we are not in agreement with the information in Paragraph 91 that states that auditors should report in their extended report if such accounting records have not been adequately kept. We believe insufficient accounting records are a reason for auditors to resign from an account or issue a modified or disclaimer of opinion. For example, if cash does not balance or isn't reconcilable, auditors should never begin work. To our mind, the question should be reframed as to whether existing statutory requirements are targeted at the appropriate level of management.

CHAPTER 7: THE COMMUNICATION OF AUDIT FINDINGS

Q33: AUDITOR & USER COMMUNICATION

Should there be more open dialogue between the auditor and the users of their reports? For example, might an annual assurance meeting open to all stakeholders prove valuable?

As we state in our response to Questions 1-3, audits of publicly listed companies are required and completed to meet the needs of investors – the residual equity owners of the company. There may be a broad array of financial statement users beyond investors (intended users). Additional users may have requests and needs – for example compliance with sustainability initiatives – that are not a part of the audit scope. Audit engagements are completed for a specific purpose with terms of engagement (e.g. compliance with IFRS). An assurance meeting with all users or stakeholders may imply audits are meant to serve broader purposes than those defined by the accounting standards, the audit engagement letter or covered by the audit opinion. As a result, such a meeting may have unintended consequences. Also, as we note in response to Questions 34 and 52, we would not be opposed to increased interaction and communication between shareholders (not simply audit committees) and auditors as it may reinforce that investors are the auditor’s client. As we note in our response to Question 25, we would favor more comprehensive audit reports to investors before widening the group of stakeholders.

Q34: PUBLIC DISCLOSURE OF AUDITOR/AUDIT COMMITTEE COMMUNICATIONS

Should more of the communication and resulting judgements that occur between the auditor and the audit committee be made transparent to users of the financial statements?

In the post financial crisis era we have continually emphasized investors want communications directly from both auditors and the audit committee separately. Investors do not want communications from auditors channeled through the audit committee. That said, investors would like a line of sight into what auditors discussed with the audit committee and how the audit committee addressed any issues brought to their attention as well as any audit committee instructions to the auditors and requests for specific areas of focus.

Additionally, in our [comment letter to the CMA related to the Statutory Audit Service Market Study](#) we supported regulatory oversight of audit committees such that these conversations are not limited and such documentation is not boilerplate.

Q35: ENHANCEMENT OF AUDIT REPORT

Should there be enhancements to the extended audit report, such as an obligation to update on key audit matters featured in the previous audit report?

Yes. Please also refer above to our modular audit opinion recommendation in Question 25. See also discussion of the audit report in Questions 8, 45, 47 and 51.

CHAPTER 8: FRAUD

Q36: AUDITORS & EXPECTATIONS REGARDING FRAUD

Do you believe that users' expectations of auditors' role in fraud detection are consistent with the requirements in UK law and auditing standards? If not, should auditors be given greater responsibility to detect material fraud?

The term “users” as utilized in this question implies a broad group of individuals with varying levels of expertise and knowledge regarding auditor’s responsibilities under UK law and auditing standards. Broadly, the public discourse in the UK post the most recent high-profile failures seems to indicate that the general public believes auditors have a much broader responsibility to identify fraud than is required under auditing and legal standards. With that said, there do appear to be situations where traditional audit procedures should have detected – in their normal course – certain elements of fraud. Without specific detailed knowledge of each situation it is not possible to conclude whether an auditor in a specific situation executed their responsibilities within the auditing requirements and failed to detect fraud. This is something a stronger statutory auditor should be responsible for assessing and communicating.

Still further, the term fraud in the colloquial sense and in the legal or accounting sense may result in different perceptions of responsibility by different users. The general public may perceive fraud and a business failure as more equivalent than they actually are. Further, fraud can be perpetrated in many ways that are far more subtle and gray than simply identifying fake transactions or misappropriated assets. Fraud can occur via inappropriate valuation of assets, overly optimistic liability accruals, aggressive impairment assumptions, limiting disclosures, rearranging segments, etc. There are many less obvious ways to perpetuate a fraud that can take years to detect.

As we listen to the discourse on fraud in the UK market, we believe not only is the perception of auditors’ responsibilities to identify and report fraud too broad, but the definition of fraud may need refining, and the responsibility to whom auditors owe a duty too broad.

We believe the Brydon Review has a responsibility to educate the public regarding auditors’ responsibilities and rebut false narratives as well as highlight situations where, in fact, the auditors did fall down on their responsibilities to detect fraud.

Overall, we believe the Brydon Review needs to recommend a separate consultation on fraud including an articulation of current requirements and suggested improvements. We worry the questions here may only illicit opinions without a robust connection to the requirements and reflecting the complexity of this issue.

Q37: FRAUD DETECTION MINDSET

Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?

Auditors first need an enhanced degree of professional skepticism as it relates to audit. See also response to Question 56. Professional skepticism must be more fully engendered before attempting to instill a fraud detection mindset.

As with the response to Question 36. We believe a separate consultation on the issue of fraud is necessary.

Q38: REASONABLE PERSON TEST

Would it be possible to devise a ‘reasonable person’ test in assessing the auditor’s work in relation to fraud detection?

As with the response to Question 36. We believe a separate consultation on the issue of fraud is necessary.

Q39: FRAUD SYSTEMS & CONTROLS

Should auditors be required to evaluate and report on an audited entity’s systems to prevent and detect fraud?

As with the response to Question 36. We believe a separate consultation on this issue of fraud is necessary.

CHAPTER 9: AUDITOR LIABILITY

Q40: LITIGATION IMPACT ON WILLINGNESS TO CHANGE

Is the audit profession's willingness to embrace change constrained by their exposure to litigation?

Certainly, exposure to litigation is a concern of auditors – in some countries more than others. As with other questions herein this question is very broad, and somewhat leading, as it implies, but does not define, the type of change that is perceived to have been limited by litigation concerns. Without identifying and analyzing instances where change has been stalled – and looking at both the formal and informal reasons for such delays, this question may illicit only opinions and not actionable input on how to balance change relative to exposure to litigation.

Changes as they relate to audit efficiency (e.g. automated workpapers, technology) have been embraced by the audit profession. That said, we have evidenced first hand auditors' resistance to change – many times overemphasizing the risk of exposure to litigation – when it comes to increased communication with investors – the stakeholders to whom they are clearly and directly accountable to. The risk of litigation has been a consistent refrain against reform in the US (e.g. critical audit matters, engagement partner disclosure). In the US, it took CFOs of companies ("clients") indicating that they, for example, are named to nudge audit firms into disclosure of audit engagement partners. We believe the reputation risk and auditor payor model – that firmly connects the auditor's interests with those of preparers rather than the concerns of investors, their actual client – limits their desire and ability to communicate with investors more than the risk of litigation.

Q41: AUDITOR LIABILITY LIMITS

If there were a quantifiable limit on auditor liability, how might this lead to improvements in audit quality and/or effectiveness?

Responding to this question would require an extensive economic analysis that incorporates the behavioral elements of such a change on all stakeholders to the audit process from company directors, company management, audit partners, audit staff to investors. In our view, such a limit would actually decrease audit quality by allowing auditors to more accurately price the risk of audit failure and balance this against the cost of increased audit quality. Still further, such liability limits would increase the cost of capital for companies as investors seek to recoup the cost of risk limitation. This equity risk premium assessment could change (i.e. increase the cost of capital and decrease share price) as company's financial results deteriorate. Such limitations could also affect the attractiveness of the UK capital markets relative to other markets without such limitations.

Q42: ACCOUNTABILITY TO ALL STAKEHOLDERS

Should company law make auditors potentially liable, or otherwise accountable, to all stakeholders who reasonably rely on their audit work and their published auditor's report?

See our response to Question 1-3 and 33. Financial statements, and audits of financial statements, of listed public companies contain information determined to be useful in the investment decision-making process based upon underlying accounting principles. The financial statements exist in the public domain for this purpose. Because they are public they can be used by a wide group of stakeholders – irrespective of whether the financial statements have been prepared for this audience. The central question is who and how will "who reasonably rely on their audit work and their published auditor's report" be interpreted. Financial statements have limitations in their use – irrespective of the

audit. The underlying financial statements do not have all stakeholders as their target audience. For this reason, we do not believe auditors should be accountable to all stakeholders.

Q43: ALTERING AUDITOR LIABILITY & AUDIT QUALITY

How might quality of the audit product be improved if the approach to liability was altered, and what reform might enable the most favorable quality improvements?

It is not precisely clear what “if the approach to liability was altered” means. As such, this is difficult to respond to in a meaningful manner. We can only presume, from the preceding questions, that altering means limiting auditor liability or expanding the stakeholders expected to reasonably rely on the auditor’s report. We do not support such reforms as we explain in our response to Questions 41 and 42.

We find the comment in Paragraph 121 in the Call Views regarding limiting the liability on wider assurance services inconsistent with the statement in Paragraph 65 that notes that some of the most influential information for analysis is outside the financial statements. Such a shift will just move information from financial statements to elsewhere in the public domain to limit liability.

Rather than altering legal liability, we believe audit quality would be best improved by changing the payor model; enhancing regulatory oversight of the auditors; implementing director/management attestation of, and audits of, internal controls; increasing disclosure and communication to investors regarding the work auditors have completed and establishing regulatory oversight of audit committees.

Q44: PROFESSIONAL INDEMNITY INSURANCE

To what extent (if any) are firms unable to obtain the desired level of professional indemnity insurance to minimise the risk of being unable to meet a significant claim relating to their statutory audit work? How significant is this risk for both the largest firms and other firms undertaking audits of Public Interest Entities?

No comments. This is a question for the audit firms.

CHAPTER 10: OTHER ISSUES

TECHNOLOGY

Q45: USE OF NEW TECHNOLOGY IN AUDITS

How far is new technology actually used in audits today? Does the use of technology enable a higher level of assurance to be given?

Investors Have Interest in Technology Deployment in Audit Process – The actual degree to which technology is used currently in the audit process is something best answered by the auditors. As an investor organization, however, we see the potential that technology has to change the audit and enhance assurance and reporting to investors. For that reason, we are participating in advisory groups on the topic at both the IAASB and PCAOB. We believe the audit firms are bringing in technological changes to the audit, but progress is constrained by client back office technologies and the need for audit standard-setting and audit regulators to move in lock-step with the auditors.

Audit Firms Will Drive Change: Engaging Audit Standard Setters – The auditors are rightly engaging the auditing standard setters and regulators to ensure that new uses of technology will meet auditing standards or that auditing standards evolve to adjust to such changes. We see the commercial interests of auditors shaping auditing standards and this commercial interest creating engagement with regulators and standard setters. As an investor organization, we see the use of technology to audit full population sets as holding the promise of reducing time spent on auditing historical transactions while at the same time providing enhanced assurance on these historical transactions.

Impact on Auditor Value Proposition to Investors – Simultaneously, this technological change creates a shift in the value proposition of auditors. With automated verification of historical transactions, auditors' time – and the value they bring to the financial information integrity ecosystem – should turn to the more subjective estimates included in the financial statements. Without an ability to provide improved assurance on these estimates, investors will question the value and price paid for a technology-based audit of historical transactions. Additionally, while audit opinions have just changed for the first time in nearly a century, technology may put greater pressure on them to change even more as we describe in our response to Question 25. With the ability to verify transactions completely, investors will want to know what portion of transactions were 100% verified and what were the focus areas of auditors beyond these transactions. The use of technology will also have significant impact on the nature and importance of the audit of internal controls. Still further, technology holds the promise of auditors being able to use external data about their clients to validate their knowledge of the client through more thorough risk assessments and greater context, for example, in evaluating viability and going concern conclusions. We also believe technology will shift the billing model of the accounting firms from one based upon hours and rates of human capital to one that includes technology deployment and greater specialist fees.

Accounting Standard Setters Slow to Act & Drive Change: Must Engage in the Technology Debate to Ensure Relevance of Underlying Information – While we see auditing standard setters engaging on technology, we do not see accounting standard setters being strategic or forward-thinking in the implications on accounting and reporting. The typical refrain is that accounting standard changes are too expensive for preparers. We don't see accounting standard setters challenging this refrain with the impact technology can have to reduce costs and make more strategic advances in reporting in the long-term to ensure the relevance of financial reporting. We see vast improvements in information delivery, tracking and monitoring of transactions (and people) in all aspects of our daily lives, but we have yet

to see a reconciliation or rebutting by accounting standard setters of this “too costly narrative” as it relates to financial reporting changes with the advances in technology. Further, with the ability to verify entire population sets, accounting standards should explore more relevant measurements of estimates such as fair value and the manner in which financial reports are delivered (e.g. in an automated fashion). Overall, we don’t see technology being implemented fast enough in the accounting and reporting space as we note in our response to Question 1.

Skills Need to Evolve: More Analysis, Less Preparation, Compilation & Rules Application – We also see the use of data and technology as needing to change the skills of the accounting and auditing profession. Typically, accountants learn and apply rules to the creation of accounting results. In our view, they need to become more like analysts than traditional accountants—using data to evaluate trends and glean insights from accounting data. This is especially true as we see the use of data analytics as the technological trend most immediately poised to change the audit process. The use and availability of data for accounting and auditing should mean greater ability to provide data and disclosures to investors.

Q46: USE OF NEW TECHNOLOGY & EXPANSION OF ASSURANCE

In what way does new technology enable assurance to be given on a broader range of issues than is covered by the traditional audit?

See response to Question 45.

PROPORTIONALITY

Q47: AUDIT OUTPUTS NO LONGER NECESSARY

Are there aspects of current audit procedures or output that are no longer necessary or desirable?

As we note in our response to Question 45, we don't foresee any procedures or output that are no longer necessary or desirable in the future per se. The notion that all footnotes do not need to be audited in Paragraph 128 of the Call for Views is certainly not a perspective shared by investors. Investors already perceive the audit quality of footnotes is less than the basic financial statements. Rather, we see technology as expanding the ability of the auditors – with the proper training and skills – to deliver more meaningful assurance and more meaningful communication on the more subjective and forward-looking information contained within the financial statements as we note in the response to Questions 25 and 45. If auditors do not move in this direction, we are concerned their value in the marketplace may diminish.

Q48: ZERO FAILURE REGIME & AUDIT VALUE CALIBRATION

Given that a zero failure regime is not attainable (and arguably not desirable) how should the Review calibrate the value of audit in relation to the limitation of potential failure?

As we highlight in our [comment letter to the CMA related to the Statutory Audit Service Market Study](#), the UK media has incorrectly conflated corporate failures with audit failures. Audit failures do not necessarily result in corporate failures and vice versa.

Investors know audits don't mean companies won't fail and that market forces – not audits – create company failures. What investors don't like is when financial results depicted based upon accounting standards do not accurately reflect economic value or assist them in determining value and when financial statements, audits and annual reports don't highlight or disclose emerging risks. In many cases, investors – with more limited information – are more accurate at predicting corporate failures than company management or the auditors because they are less biased in their assessment and they seek to discover economic value rather than report on accounting standards. (See Question 15-19) As such, we don't believe it is economically feasible to calibrate the value of an audit to the limitation of potential failure. Rather, investors need more information on the most significant uncertainties and how they are audited as well as improved financial statements and statements of cash flow to assess to establish a more meaningful correlation to the company's valuation.

Q49: AUDIT & VALUE FOR MONEY

Does today's audit provide value for money?

Investors, as the residual equity owners of the company, pay the audit fee. They are the ultimate buyer of audit services in publicly listed companies. See our responses to Questions 57 to 59 regarding audit fees. Overall, our view is that because buyers of audit services (investors) have insufficient information on both audit fees, the audit procedures performed and the quality of the audit, they cannot truly judge whether there is good value for money when it comes to audit. Unlike other markets for goods and services, in the audit market there is insufficient information for buyers to be able to judge audit quality. We think the Brydon Review should consider thoroughly how the buyers of audit services are able to make a quality assessment, and how others (e.g. audit committees) responding to the Call for Views and answering this question are making this assessment.

In our view – and as we note in our [comment letter to the CMA related to the Statutory Audit Service Market Study](#) – there is herding behavior to the Big 4 when it comes to auditor selection because there is an inability to judge quality. While the concept of the audit – and its potential to deter wrongdoing is present – would suggest audit is a valuable endeavor, the analysis is actually more complicated than this. That said, investors have little information to make a true value for money assessment. See also our comments in Question 1 and 45 regarding technology and the future of the audit.

Q50: COSTS VS. BENEFITS OF EXTENDING THE AUDIT

How should the cumulative costs of any extension of audit (whether stemming from this Review or other drivers of change) be balanced against the likely benefits to users?

We interpret the “extension of audit” referred to in the question above to be an extension of the audit in terms of the information audited and the audit opinions offered as noted in Paragraph 127 of the Call for Views. Investors would need to consider each extension of the audit both individually and collectively to make a reasoned cost/benefit analysis. Further, investors would need to be convinced that auditors – who are under significant scrutiny in the current marketplace – should have their responsibilities extended. Investors need to see improvements in audit quality (as we define herein) related to current work and opinions expressed before extending auditors’ work to other types of information.

We would also caution that many cost/benefit analysis in the accounting and auditing standard-setting realm heavily focus on claims of increased costs to preparers (costs ultimately borne by investors as owners of the company) but fail to quantify the cost of not having the information (or the benefit of obtaining the information) to investors. The adoption of the new leasing standard vividly illustrates this. While preparers claim challenges in adoption (e.g. identifying leases) and quantifying impacts they fail to recognize this cost is already being borne by a multitude of investors in the company who guesstimate such adjustments manually.

It is also important to remember that investors have limited insight into audit fees. As such, more information on the fees associated with extending assurance would have to be provided alongside the nature of the work to be extended such that an accurate cost/benefit assessment can be made.

SHAREHOLDERS

Q51: SHAREHOLDERS USE OF AUDIT REPORTS

What use do shareholders currently make of audit reports? Are they read by shareholders generally? What role does AI play in reading and analysing such reports?

CFA Institute was a key advocate for audit reporting reforms as our numerous investor surveys ([2008](#), [2010](#), [2011](#) and [2012](#)) showed that investors wanted more information from auditors regarding their work as the binary boilerplate opinion added little value. We communicated such findings to the IAASB and PCAOB during their development of the new auditor's reporting model. We found investors also wanted to know the issues auditors faced in the completion of their work, the duration of the auditor relationship and the name of the audit engagement partner. CFA Institute supported these improved disclosures over mandatory rotation. While CFA institute recognizes the "stickiness" of auditor decisions, we believed disclosure of key issues and transparency of tenure such that investors could advocate for change, should they perceive it to be necessary. We also advocated for disclosure of engagement partner names to increase accountability by audit partners – and to decrease the influence of client service partners.

With the introduction of extended auditors reporting in the UK in 2013, key audit matters by the IAASB in 2016 and critical audit matters in 2019 in the U.S. more information has been, or will be, made available to investors. Studies by the [ICAEW](#) and [ACCA](#) provide some useful insights on the initial years of key audit matters, but CFA Institute has not completed a study as of yet on the nature, completeness and quality of key audit matter disclosures as we are waiting until such time as the US provisions related to critical audit matters come into effect such that we can compare US disclosures with a sample in the UK and globally. CFA Institute did do a study [New Public Company Auditor Disclosures: Who Audits the Company You Invest In?](#) last year looking at the auditor tenure and audit partner names disclosed for the first time in the US. We plan to do an analysis in 2020 of the key and critical audit matter disclosures globally. When completing the auditor tenure disclosures in the US we used CalcBench (XBRL) data. Though the audit opinions are not tagged in preparer filings in the US, certain data providers are tagging key data elements (e.g. tenure) in audit opinions to make them searchable for investors. We expect this to occur for critical audit matters beginning in early 2020. We intend to use this data for our work. The challenge in the UK and Europe is that there isn't tagging of data or central data repositories like EDGAR in the US. As such, the work is more manual. While these first years of key or critical audit matter will be useful, the real benefit of such data is over time where investors can compare the discussion of such matters to manifestations in results. One issue we have highlighted as an investor organization is that we believe the new extended auditors' report puts an additional onus on the auditors to reconcile their view of key and critical audit matters with those expressed publicly by investors. Auditors now must recognize their analysis of key items can be reconciled with those of investors in the market place.

We believe investors are reading the extended auditors reports and considering the assessment of risk and procedures done by auditors. As we highlight in our response to Questions 1, 25 and 45 there is, however, more to do to contextualize these audit reports with the financial statements and to improve financial reporting to provide greater context and detail of the historical and/or cash-based transactions versus transactions or balances that are more subjective and judgmental. Investors want an even clearer line of sight into the financial statement implications of the key or critical audit matters.

In the US we expect technology to be further deployed to read, compile, compare, analyze and synthesize audit reports given there is a central repository of audit reports. We have seen evidence

opinion information can be tagged by data providers in the most recent updates. Outside the US the lack of central repositories and tagged XBRL data makes the application of technology to broad swaths of data and listed publicly companies more challenging without, or even with purchasing, expensive data sources.

Q52: AUDITOR & SHAREHOLDER INTERACTION

Would interaction between shareholders and auditors outside the AGM be practical and/or desirable?

During the debate regarding reforming the audit opinion, there was substantial push-back from auditors noting that communication to investors should come from management and the audit committee – not the auditor. Investors resoundingly rejected this view – indicating that each of these constituencies work for investors and play a role in protecting their investment and, for that reason, should have a responsibility to communicate to auditors. As such, we would support more direct interaction between auditors and shareholders – if for no other reason to create a tangible illustration to auditors that their client is investors – not management or the audit committee. Many auditors refer to the preparer as their client, when in fact the client is the investor, and the behavioral implications of such an interaction may be very important to shifting this paradigm for audit partners and staff. That said, our response to Question 33 highlights that broader interaction with all stakeholders has potential ramifications on who the intended user of the financial statements is or should be.

Q53: SHAREHOLDER EX ANTE CONSIDERATIONS

How could shareholders express to auditors their ex ante anxieties to help shape the audit plan? Should shareholders approve planning matters for each audit, including scope and materiality?

Analysts develop and share a variety of information and research publicly, for free or for purchase, regarding their views on the prospects and value of a company. Included in such information are their concerns regarding risks, strategies, acquisitions, industry outlook, industry position, quality of disclosures, and a plethora of other matters. News services also aggregate and summarize information regarding companies. Ever increasing sources of alternative data are emerging to allow investors to better understand companies they seek to invest in and to develop correlations between data and drivers of financial performance or value. The relevance of such information to investors is established by statistical correlations and auditors are not involved in the provision or transmission of this information (i.e. establishing its reliability) to investors.

Few auditors, in our experience, obtain and read such information as part of the planning process – and still fewer have audit staff executing procedures in key areas based upon review and understanding of such information. Ironically, we have also found that many of those charged with preparing financial statements within companies and the auditors have little knowledge of who the key investors – or short sellers – in the company are and the degree to which they use financial statements (e.g. passive vs. active).

Incorporating an external analysis of market sentiment on the company seems to be a missing – but increasingly important – ingredient in the audit process. With the need to extend their audit report, auditors need to better understand the context for their audit opinion and the markets perception of the key matters. In certain of the recent failures, it appears the market may have known more about the company than the auditors.

While buy-side investors and hedge funds may not share their concerns publicly – as it may form a basis for their investment thesis – there is a plethora of information regarding the company from analysts that auditors could consider on an ex ante basis when preparing their audit plan. Practically speaking it would not be possible for shareholders to approve planning matters including scope and materiality without significantly more information from the auditor in the reporting process. It would be educational for auditors to discuss financials with investors – if nothing more than for investors to educate auditors on the use of the financial information they audit and how to make materiality assessments.

Q54: SHAREHOLDER ASSURANCE OTHER THAN AUDIT REPORTS

What assurance do shareholders currently obtain other than from audit reports?

As we note in our response to Question 7, the definition of assurance seems to be being used in a broader sense in the Call for Views that investors might define it. Many investors don't consider there to be true "assurance" in other than the audit opinion – as it is the only place where an independent third party states they provide verification. In the context of this Call for Views, it appears the term assurance applies also to statements made by management or the board of directors.

As we note in our response to Questions 21 and 22, we agree with the statement in the Call for Views (Paragraph 65) that states: "There may be confusion over which information disclosed by company has been subject to audit." There is significant disparity amongst investors in their knowledge of the degree to which auditors are involved in other disclosures provided outside of the financial statements in annual reports, registrations statements or in earnings releases, for example. When investors are asked if they want more auditor involvement in such information, some investors will indicate they do not want auditors involved as it will constrain what management is willing to say, while still others want auditors involved. We highlight in Question 21 numerous survey results on other types of information and the assurance investors do or don't want on such information.

It should be noted, however, that investors seek out a multitude of sources of information to provide them confirmatory value to support or refute their investment thesis. This can include public news sources, regulatory filings, suppliers, customers, product market information, insider trading information, sustainability information and a plethora of emerging sources of data. And while auditors focus on the reliability of information investors focus on the relevance of information. Such relevance is established through correlation and predictive capacity – which is what most who are finding alternative data useful are seeking to demonstrate. In such a way they have assurance the information is useful – even though it might not be deemed reliable under auditing standards. Said differently, statistics rather than auditors and standard setters are demonstrating reliability and relevance.

With more specificity on the types of information or definition of assurance we might be able to provide more specific input.

We note the comment in Paragraph 134 the comment: *Finally, there is no clear analysis of the wishes of shareholders in relation to audit scope, even though currently the law makes clear the audit is carried out for their benefit.* We don't share this view. **Appendix A** provides a plethora of examples of how investors have sought to communicate their audit needs to investors. And the response to Question 21 provides views on auditors' involvement in other types of information. Most recently, in 2018, we published a survey, [*2018 Audit Value, Quality and Priorities*](#). As such, we don't believe the statement is Paragraph 34.

CULTURE

Q55: AUDITOR REPORT ON CULTURE

In what way would it be possible for auditors to report on the culture of the entity whose financial statements are being audited?

Many auditors are surprised to learn the degree to which investors assess the behavior of management and the culture of the company. Investors read comments on websites such as Glassdoor and some will inquire about employee engagement surveys. Recently, investee companies are performing culture surveys that investors may find useful. Sophisticated investors also make assessments regarding the degree to which company management is conservative or aggressive in its communications and accounting practices. As we noted in a webcast, [*Managers or Analysts: Whose Tone Matters More on Earnings Calls*](#), several years ago sophisticated investors judge management tone – an element of culture – on conference calls to assess potential performance. Similar natural language processing techniques are being used to assess the tone and hedging language in public financial statements and listing documents. These give investors insight into the overall tone and culture of the company and more importantly its management.

We are concerned with comments that suggest boards and audit committees should make cultural assessments. Much of what boards and audit committees receive from management is artfully crafted, edited and rehearsed. Further many board and audit committees only interact with upper management in orchestrated settings. Boards and audit committees have little exposure to lower levels of management and line employees where they can get a read on the actual culture of the organization and the influence of upper management on that culture.

Auditors regularly perform an overall assessment of the tone from the top and the overall control environment. However, there have been high profile situations where it is evident auditors have not fully embraced the impact of the culture on their client acceptance or retention decisions, risk assessments and audit procedures on subjective estimates or significant transactions. Further, this overall tone from the top may not, but should, permeate the entire audit team and the work performed at every level.

While there are certainly metrics emerging to make cultural assessments, the real question is whether auditors are qualified to evaluate such assessments and translate the culture's impact on the company, its financial performance and ultimately its financial statements. Further, if the ability of auditors to exercise professional skepticism in the execution of more traditional audit procedures is being questioned herein, it seems antithetical to believe auditors will possess the requisite mindset for a rigorous cultural assessment. Still further, the call to split the Big 4 firms into audit only practices raises a question regarding how that narrowing of the firms' expertise reconciles with the broadening of responsibilities as suggested by this question.

Q56: AUDITOR SKEPTICISM

How can auditors demonstrate that appropriate skepticism has been exercised in reaching the judgements underlying the audit report?

Sufficient auditor skepticism has been a subject of significant debate in the audit standard-setting and regulatory community in the years post the financial crisis. Both the IAASB, [*Toward Enhanced Professional Skepticism*](#), and the PCAOB, [*Maintaining and Applying Professional Skepticism in Audit*](#), have issued publications on the topic. While we believe the publications include useful information, the reality is the payor and incentive model for auditors prevents this from being implemented in the most important situations (e.g. going concern) because auditors fear alienating and losing clients. Said differently, the theory of professional skepticism disintegrates with the reality of the business model. We believe a stronger regulator who provides auditors with a “bad cop” to blame for having to ask and document these questions, and who oversees the implementation of professional skepticism through review of auditors workpapers, is essential. We don’t believe audit committees have sufficient skill, time or proclivity to be able to judge the degree to which professional skepticism has been applied. Further, investors have limited – if any ability – to assess whether appropriate skepticism has been exercised. Expanded audit reports provide very limited information with which to glean this from discussion of audit areas or procedures employed. From an investor perspective, the only real means to enhance auditor professional skepticism is to either change the auditor payor model or create a stronger audit regulator – who also has regulatory oversight of the audit committee.

COST

Q57: AUDIT FEE REMUNERATION DISCLOSURES

Should the basis of individual auditors' remuneration be made available to shareholders?

In our [comment letter to the CMA related to the Statutory Audit Service Market Study](#) we made the following observation regarding audit fees:

Audit Fees – We worry when audit committee members laud their ability to reduce audit fees as if to engender themselves to management or flex their muscle on auditors who seek to retain their “clients”. Investors – those who pay the bill – are less price sensitive to audit fees than one might expect. While the cost of an audit is important, pressuring auditors to reduce fees to the point where they are not allowed to make reasonable profits on the audit alone is not a model investors support, as it reduces audit quality. Auditors should be in position to make a reasonable profit in the provision of such services. Audits should not be loss leaders for the Big 4 as audit partners need to be seen as executing a valuable service to the firm. Partners should not be more highly valued for winning “clients” than performing quality audits.

We believe that competition is fierce among the Big Four within the confines of tendering rules and mandatory rotation in certain jurisdictions. That said, our view is that competition is largely based on audit fees (price) and delivery of services – not necessarily on audit quality. Currently, it is difficult for investors to challenge the audit committees or auditors who are meant to serve their interests as audit fees are very hard to compare across companies. They are generally large lump sums with very high-level qualitative explanations. This fee reporting, and the tendering process create perverse incentives where the Big 4 underbid large clients to gain the work knowing that there are high switching costs and that without mandatory rotation they have the hope of raising fees and creating a lengthy annuity for the audit firm. They also seek to gain clients for name recognition, marketing, and market sector expertise, and, as we said above, because sales rather than line partners are more highly rewarded for winning clients – even at bad prices. We believe greater reporting on the audit fees including the hours and fees – associated with significant audit areas or risk areas – would provide greater information content to all market participants and provide them with greater ability to judge the fairness of fees for the company relative to the disclosures in the auditor report and relative to peers.

Investors need greater reporting on audit hours, staff mix of hours, and rate per hour to be able to be well informed participants in the market place. Adding additional challenger firms has the potential to increase competition on price – without transparency to the buyer. It is not in the best interest of investors to increase competition for the audit without simultaneously providing better communication from the audit committee on a variety of issues including fees to allow the market to work more efficiently.

As we note above, investors do not have the necessary insight to judge audit fees and the nature of fees relative to audit risks. We believe investors are willing to pay higher fees for audits if they perceive there is value for money. Our overarching point in the CMA letter is that the CMA is seeking to increase competition in the audit market by creating more sellers but not dealing with the real issue – a lack of transparency to buyers of audit services.

The lack of information with respect to fees, combined with limited information from the auditor in the audit opinion and little information on audit quality from regulators leads to an audit market where the end buyer – investors – do not have sufficient information to judge audit quality, the price of the audit or the value of the audit. While audit committees are charged with engaging auditors, we do not believe they have sufficient information to make such judgements either. And, as we have said elsewhere herein, investors engage both audit committees (and boards more broadly) and auditors to protect their interests and they want to hear from both parties, separately.

Q58: LEVEL OF AUDIT FEES

Do respondents view audit costs as generally too high, about right or insufficient?

Anecdotally, we hear that fees are insufficient, and overruns can be challenging to ask for, let alone, collect. See also our response to Question 57.

Q59: DETAIL ON AUDIT FEES

Would users of financial statements wish more detail on the make-up of audit fees?

Yes – unequivocally. See response to Question 57.

Q60: PROFITABILITY OF AUDIT FIRMS

Is the profitability of the audit function sufficient to sustain a high-quality audit industry?

Investors have virtually no visibility into the profitability of the audit industry charged with protecting its interests. As a result of the recent inquiries by the BEIS (Business, Energy and Industrial Strategy Committee) and the Future of the Audit Report we understand audits remain profitable. That said, we agree with much of what is said and recommended in Chapter 5 of [The Future of Audit](#) report. Please also see response to Question 57 where we address the notion of line audit partners being seen, within the audit firms, as providing as less valuable contribution to the firms than sales and consulting partners.

We would also note that any other changes in the scope of the audit function, auditors' liability, and the audit product will, and should, have fee considerations.

Sincerely,

/s/ Sandra J. Peters

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Sr. Head, Global Financial Reporting Policy
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AUDIT RELATED CONTENT

AUDIT BLOGS

a. Audit Reports

- i. **Let's Make the Auditor Report More Informative**
<https://blogs.cfainstitute.org/marketintegrity/2011/05/04/lets-make-the-auditor-report-more-informative/>
- ii. **Investor Preferences Being Considered for Auditor's Reporting Model**
<https://blogs.cfainstitute.org/marketintegrity/2011/03/28/investor-preferences-being-considered-for-auditor%E2%80%99s-reporting-model/>
- iii. **Company Audits — Are Shareholders Getting Enough?** <https://blogs.cfainstitute.org/marketintegrity/2011/07/05/company-audits-%E2%80%94-are-shareholders-getting-enough/>
- iv. **Audit Transparency and Accountability: The Engagement Partner Should be Disclosed**
<https://blogs.cfainstitute.org/marketintegrity/2014/01/14/audit-transparency-and-accountability-the-engagement-partner-should-be-disclosed/>
- v. **Navigating a Maze: Audit Profession's Solution for Disclosing Engagement Partner**
<https://blogs.cfainstitute.org/marketintegrity/2014/03/11/navigating-a-maze-audit-professions-solution-for-disclosing-engagement-partner/>
- vi. **PCAOB Plan on Naming Audit Partner Is a 'Small Ball' Advance for Investors**
<https://blogs.cfainstitute.org/marketintegrity/2014/10/23/pcaob-plan-on-naming-audit-partner-is-a-small-ball-advance-for-investors/>
- vii. **Investors to Benefit from Much-Improved Auditor's Report** <https://blogs.cfainstitute.org/marketintegrity/2015/01/27/investors-to-benefit-from-much-improved-auditors-report/>
- viii. **Balance in Public Company Audit Priorities Important to Investors**
<https://blogs.cfainstitute.org/marketintegrity/2015/02/27/balance-in-public-company-audit-priorities-important-to-investors/>
- ix. **With PCAOB Form, Finally Maybe Some Transparency into Identity of US Audit Partner**
<https://blogs.cfainstitute.org/marketintegrity/2015/08/03/with-pcaob-form-finally-maybe-some-transparency-into-identity-of-us-audit-partner/>
- x. **Seven's a Charm for Investors: PCAOB Disclosure of Engagement Partner Finally Reality**
<https://blogs.cfainstitute.org/marketintegrity/2016/05/12/sevens-a-charm-for-investors-pcaob-disclosure-of-engagement-partner-finally-reality/>
- xi. **Investor Expectations Are High That the New Auditor's Report Won't Be Al Capone's Vault**
<https://blogs.cfainstitute.org/marketintegrity/2016/07/19/investor-expectations-are-high-that-the-new-auditors-report-wont-be-al-capones-vault/>

b. Audit Reforms

- i. **Audit Reform—What Is the Optimal Way Forward?**
<https://blogs.cfainstitute.org/marketintegrity/2018/02/15/audit-reform-what-is-the-optimal-way-forward/>

c. Audit Quality

- i. **Enhancing Audit Quality: Lessons from Auditor Deficiencies and Accounting Restatements**
<https://www.cfainstitute.org/en/advocacy/market-integrity-insights/2013/07/enhancing-audit-quality-lessons-from-auditor-deficiencies>
- ii. **Let's Make the Auditor Report More Informative**
<https://blogs.cfainstitute.org/marketintegrity/2011/05/04/lets-make-the-auditor-report-more-informative/>

d. Evolving Audit Services

- i. **Heads Up Investors! The Implications of Evolving Audit Services**
<https://blogs.cfainstitute.org/marketintegrity/2017/05/01/heads-up-investors-the-implications-of-evolving-audit-services/>

e. Going Concern

- i. **Continued Concern for "Going Concern" Reporting**
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- ii. **"Going Concern" Warnings: Fewer Firms Improved in 2012 and Its Impact on Investors**
<https://blogs.cfainstitute.org/marketintegrity/2013/10/09/going-concern-warnings-fewer-firms-improved-in-2012-and-its-impact-on-investors/>
- iii. **Investor Win: FASB Proposes Enhanced "Going Concern" Warnings for U.S. Firms**
<https://blogs.cfainstitute.org/marketintegrity/2013/07/01/investor-win-fasb-proposes-enhanced-going-concern-warnings-for-u-s-firms/>

f. *Alternative Performance Measures –*

Blog – Investors Require Improvements in Reporting of Alternative Performance Measures

<https://blogs.cfainstitute.org/marketintegrity/2018/02/28/investors-require-improvements-to-apm-reporting/>

Survey –

<https://www.cfainstitute.org/-/media/documents/survey/alternative-performance-measures.ashx>

Blog – Time to Focus on the Forgotten Middle across Financial vs. Non-Financial Information Spectrum

<https://blogs.cfainstitute.org/marketintegrity/2018/02/27/time-to-focus-on-the-forgotten-middle-across-financial-vs-non-financial-information-spectrum/>

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Blog – Implications of the Widening Spectrum of Useful Corporate Information

<https://blogs.cfainstitute.org/marketintegrity/2017/03/28/implications-of-the-widening-spectrum-of-useful-corporate-information/>

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a. *Audit Report (IAASB) (2011)*

<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20111014.ashx>

b. *Audit Report (IAASB) (2011)*

<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20110930.ashx>

c. *SOX (Congress) (2011)*

<https://www.thecaq.org/caq-joins-cii-and-cfa-institute-urging-lawmakers-oppose-efforts-weaken-sarbanes-oxley-investor/>

<https://www.aicpa.org/content/dam/aicpa/advocacy/issues/downloadabledocuments/404b/caq-cii-cfa-404-letter-92011.pdf>

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d. *Audit Partner Signature (PCAOB)(2012)*

<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20120123.ashx>

e. *Auditor Report PCAOB and IAASB (2013)*

<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20131230.ashx>

f. *SAG Agenda (PCAOB) (2013)*

<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20130115-2.ashx>

g. *Engagement Partner (PCAOB) (2015)*

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h. *Quality & Skepticism (IAASB) (2016)*

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i. *Technology (IAASB) (2017)*

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j. *Estimates (PCAOB) (2017)*

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k. *Strategic Plan (PCAOB) (2018)*

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m. *Monitoring Group (IAASB)(2018)*

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- a. **2008 Audit Report –**
<https://www.cfainstitute.org/-/media/BB0BD74DDE6B429894795707040D266E.ashx>
- b. **2010 Audit Report**
https://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf
- c. **2011 Audit Report** https://www.cfainstitute.org/Survey/usefulness_of_independent_auditors_report_survey_results_march_2011.pdf
- d. **2012 Going Concern**
<https://www.cfainstitute.org/-/media/80CB5D87DF2843F0BBDC216A3025CC54.ashx>
- e. **2018 Audit Value, Quality and Priorities**
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- a. **Forward Looking Information**
<https://www.cfainstitute.org/-/media/documents/article/position-paper/forward-looking-information-a-necessary-consideration-in-sec-review.ashx>
- b. **Non-GAAP Measures**
 - i. Investor Uses, Expectations, and Concerns on Non-GAAP Financial Measures <https://www.cfainstitute.org/-/media/documents/support/advocacy/investor-uses-expectations-concerns-on-non-gaap.ashx>
 - ii. Bridging the Gap: Ensuring Effective Non-GAAP and Performance Reporting
<https://www.cfainstitute.org/-/media/documents/article/position-paper/bridging-the-gap-ensuring-non-gaap-and-performance-reporting.ashx>

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