



June 5, 2019

Sir Donald Brydon
Brydon Review Secretariat
Orchard 1, 1st Floor
1 Victoria St
London SW1H 0ET

Re: Independent Review into the Quality and Effectiveness of Audit

Dear Sir Donald:

The American Institute of Certified Public Accountants (AICPA) is pleased to respond to the above referenced Consultation Paper.

The AICPA is the world's largest accountancy body representing more than 431,000 members in 143 countries with a history of serving the public interest since 1887. AICPA members represent many areas of practice, including management accounting, public accounting, government, education, and advisory. Among other things, the AICPA sets (a) ethical and independence standards for the U.S. accountancy profession, (b) U.S. auditing standards (generally accepted auditing standards or GAAS) for financial statement audits of non-listed entities; (c) U.S. attestation standards (Statements on Standards for Attestation Engagements or SSAEs) for assurance on non-financial subject matter; and (d) standards for financial statement preparation, compilation, and review engagements (Statements on Standards for Accounting and Review Services or SSARs). In addition, the AICPA develops and grades the Uniform CPA Examination and administers the AICPA Peer Review Program.

Because our membership spans 143 countries, including members in the UK, we have a keen interest in the subject matter of this Review. We have a particular interest in the impact the results of this Review may have internationally outside of the UK and the consequences for global practice and the global economy. Overall, we support this Review being undertaken and agree that many of the questions asked in the Consultation Paper are important and worthy of consideration from a global perspective. As noted in the Consultation Paper, we also strongly support the position that most audits are conducted to a high quality and that the good should not be discarded in a search for the better.

We believe there are two key factors that should be considered in recommending any changes as a result of this Review. The first key factor is determining the identity of the users of financial and non-financial corporate information. The value of audit and whether the audit serves the public interest can only be assessed based on whether the needs and expectations of users are met. These needs and expectations can vary greatly depending upon the user. For example, for audits of listed entities the needs and expectations of investors may be different than the needs and expectations of prudential regulators. The second key factor is related to the first but is more

specifically a need to describe what is meant by the “public interest.” Arguably, all auditors would say that they discharge their work and produce the audit product in the public interest, but diverse views exist as to what “acting in the public interest” means.

We acknowledge that this Review is being conducted specifically with regard to the UK audit market following on from several corporate failures, but we caution against viewing the potential impact of recommendations coming from this Review too narrowly in the context of the UK environment. For example, we expect that the results of the Review will likely impact the international audit market in general, but many audits are undertaken in jurisdictions with limited statutory audit requirements. Audits in jurisdictions outside of the UK are also of importance to UK companies with operations outside of the UK.

Our responses to specific questions posed in the Consultation Paper follow (we have not responded to certain questions that are UK-specific nor address topics where we lack a basis upon which to respond).

Responses to Specific Questions

Q1. For whose benefit should audit be conducted? How is it of value to users?

Response: Audits are performed in the public interest, but as noted in our overall comments what is meant by the public interest requires more specific description. We believe that in the UK, a more prudential view of users exists while investor views are more prevalent in the US. The value of audit is to provide users with confidence that the information they use to make decisions about the allocation of their resources is true and fair (or fairly presented). However, users of financial and non-financial corporate information of listed entities are the shareholders, but there are many types of secondary users such as employees, customers, lenders, regulators, government agencies and pension schemes among others.

Q2. Should the audit be designed to enhance the degree of confidence of intended users in the entity or just in the financial statements?

Response: Broader assurance services addressing the degree of confidence in the entity are dependent upon development of criteria against which the entity would be measured. Currently the audit only addresses the financial statements because well developed criteria exist (financial accounting frameworks) against which to measure whether financial statements present a fair and true view or are presented fairly. We believe users have a desire to learn “what the auditor has to say” about matters related to the entity, but outside of the financial statements. Auditors have a unique insight into an entity not shared by others. However, because the views of auditors about other aspects of the entity would be judgmental and more qualitative, this type of auditor reporting could quickly evolve to users believing the auditor was certifying the quality of an entity and thus widening the existing expectation gap. Also, expansion of auditor reporting in this regard would result in higher audit costs with those costs likely passed on indirectly to society in general, thus careful cost/benefit and economic impact studies would need to be conducted.

We do believe that expanded auditor reporting on the financial statements, including the reporting of Key Audit Matters (KAMs) for financial statement audits of listed entities provides transparency and makes more information about the audit of the entity's financial statements available to users of the audited financial statements. We believe that a study (e.g., a post-implementation review) should be conducted to determine whether KAM reporting is making a difference and provides useful information. We also believe that entities reporting in accordance with the Integrated Reporting framework <IR> which includes reporting on six sources of capital for the entity in addition to the financial statements represents an opportunity to provide users with an expanded view of the entity.

Q4. Do respondents consider there is an expectation gap?

Q5. If so, how would respondents characterise that gap?

Q6. 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?

Response: Yes, there is an expectation gap that has existed for decades. There are two components to the wider expectation gap. The first component of the expectation gap exists within an audit of the financial statements where users' expectations of the nature of a financial statement audit differ from the requirements of the current auditing standards to which the auditor is subject. The second component of the expectation gap exists more generally about the relationship between the auditor and the entity it audits where users believe that the auditor does much more than just audit the financial statements.

A "gap" by definition has two ends. While auditors should be held accountable for complying with standards, an educational effort is needed to inform users about reasonable expectations, what the auditing standards require, and the cost of changing those expectations. Auditors will perform in accordance with the standards so if expectations of users are not being met, we should question whether the standards need to be changed and/or whether assurance on non-financial statement subject matter is the solution. If an expectation gap is widened because auditors are not performing audits in accordance with the auditing standards, then we support addressing this "delivery gap" through regulatory inspection, oversight and sanctioning.

Lastly with respect to the expectation gap, we believe greater efforts need to be undertaken to more clearly and publicly articulate the expectations and responsibilities of directors of the entity. The auditor is not and should not be responsible for aspects of the entity's operations such as the adequacy of records, capital maintenance and inappropriate dividend payments.

Q7. What should be the role of audit within wider assurance?

Response: We believe that the current financial statement audit has a role in wider assurance but that in the context of wider assurance there would be two components: (1) the financial statement audit, and (2) the "audit" of the entity's societal role. In the US practitioners make extensive use of a well-developed array of attestation standards for examinations of non-financial matters and information. If the wider assurance model were used, we believe certain differences under which the two components of the audit are undertaken should be created. For example, the audit of the

entity's role in society could have differing safe harbors and protection of auditors as the criteria against the societal role would be measured are more judgmental, qualitative and less developed.

Q8. Can the 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?

Response: We believe that if the audit were expanded beyond the financial statements (as discussed in response to Q7, above), it may be possible to vary the level of assurance required for the auditor to obtain in order to opine on matters outside of the financial statements. As a practical matter however, we are more concerned that varying levels of assurance would only widen the existing expectation gap and thus not be of overall benefit, in other words, "an audit is an audit."

Q9. Are the existing boundaries between internal and external audit clear?

Q10. To what extent should external auditors be able to use evidence obtained from work performed by internal auditors in drawing conclusions?

Response: Yes, we believe the boundaries between internal and external audit are clear. We also believe that the requirements for an external auditor to use the work of internal auditors as contained in the current auditing standards are appropriate.

Q12. 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?

Response: As stated previously, we believe that the expectations and responsibilities of directors in general should be more clearly identified and communicated. In the US, since the Sarbanes-Oxley Act we have required the entity to report on the effectiveness of its internal control over financial reporting and CEO/CFO certifications in this regard are required. We believe this practice has had positive impact in the US market and as such, we recommend that this course of action be pursued in other jurisdictions.

Q13. Should auditors' responsibilities regarding assessing the effectiveness of an entity's system of internal control be extended or clarified?

Q14. Auditors are currently required to report to audit committees their views on the effectiveness of relevant internal controls for listed and other relevant entities. Should auditors be required to report publicly these views?

Response: In the US, section 404(b) of the Sarbanes-Oxley Act requires the auditor to report on the effectiveness of the entity's internal control over financial reporting for audits of listed companies and certain other issuers, excluding exemptions for Emerging Growth Companies.

When auditor reporting on the effectiveness of internal control over financial reporting for listed companies became effective in the US, the cost of audits increased significantly. However, as experience was gained with these requirements by both the entity and the auditor, scaling occurred, and we believe that currently the costs are commensurate with the benefits of such

reporting and the requirements have had a positive effect on the effectiveness of internal control over financial reporting for listed entities.

As such, we believe this reporting regime should be considered elsewhere. While it is important to note that for audits of non-listed entities auditor reporting on internal control over financial reporting is not required, evaluating the entity's internal control over financial reporting is still required as part of the financial statement audit.

Q15. Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?

Q16. 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”?

Response: We are aware that an FRC Consultation (March 2019) proposes to extend ISA 570 to require an audit conclusion on whether management’s assessment of the use of going concern is appropriate and for the auditor to state the work done in this respect. While acknowledging that viability statements are not required in the US, we oppose the proposed extensions of ISA 570 because we believe that those requirements and the resulting reporting, if use of going concern is a significant matter, are sufficient. Compliance by the entity with company law and accounting standards (that is, appropriate disclosure) combined with the auditor’s compliance with extant ISA 570 reporting requirements serve to provide users with the necessary information related to significant doubt about the entity’s ability to continue as a going concern.

Q20. Is there a case for a more forward-looking audit? What would be the main benefits and risks?

Q21. 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?

Response: We believe the question asks about auditing forward-looking information rather than a forward-looking audit. We draw this distinction because auditing forward-looking information assumes that such information was produced by the entity, which is important for purposes of auditor independence. We believe that the door should be open to more forward-looking information and KPIs being included in reporting packages which may necessitate additional requirements being established by regulators. If it is believed that more audited forward-looking or other information were to be in the public interest, then we would support such efforts. Auditors possess the capabilities to perform audit procedures on information outside of the financial statements, but a framework or criteria would need to be established for the presentation of such information. ISA 720 “Other Information” currently addresses the auditor’s responsibility for reporting inconsistencies between information contained in the financial statements and other information in annual reports and was recently amended to require a statement in the auditor’s report about the work done by auditors. A very important consideration in this context is that while auditors have the capabilities to expand audits in this way, expanding assurance over forward-looking information may very well come with increased audit costs due to increases in auditor liability insurance coverage and as such, an economic impact analysis should be conducted. Perhaps affording auditors safe harbors in this regard

would be appropriate due to the nature and subjectivity of the subject matter upon which reporting done.

Q23. Do respondents agree that the value and quality of the audit product should be considered separately from the effectiveness of the audit process?

Response: We believe it is very difficult to separate the value and quality of the audit product from the process used to produce the product. To assert that the product should be separated from the process used is to imply that the auditing standards followed by auditors are not fit for purpose. The auditing standards are established in the public interest with the assumption that serving the public interest is premier and therefore of value and accordingly an audit performed (i.e., the process) in accordance with those standards should produce a valued product.

Q25. What additional benefit might a switch from a binary audit opinion to a more graduated disclosure of auditor conclusions provide?

Response: We believe that graduated conclusions may be more meaningful to users, but without clear criteria to determine when the auditor should arrive at differing gradations, the information is much less useful and the variability from engagement to engagement, firm to firm, auditor to auditor likely detracts from any incremental value. We believe that the current auditor reporting regime of a binary audit opinion supplemented with the auditor reporting of Key Audit Matters for audits of listed entities provides more transparency about the auditor's views of significant matters encountered in the audit.

Q26. Could further narrative be disclosed alongside the opinion to provide more informative insights?

Q27. What would prevent such disclosures becoming boiler plated?

Response: The new auditor's report now required is the new model around the world with much more information provided about management and auditor responsibilities. Additionally, we believe that ISA 701 that deals with reporting Key Audit Matters is also a viable path for an auditor to follow should significant matters impact the auditor's report. If narrative were required beyond that required by either ISA 700 or ISA 701 then safe harbors may need to be provided as the narrative would likely be much more subjective in nature. Such safe harbors may be effective in preventing such disclosure from becoming boiler plated.

Q28. To what extent, if any, has producer-led audit (including standards-setting) inhibited innovation and development for the benefit of users?

Response: Effective standard-setting requires an appropriate mix of users, regulators, academics, auditors and other stakeholders. We believe it is critical that auditors be involved in standard-setting because they bring a practical, experience-based perspective to the actual performance of the engagement subject to the standards being established. In any case, innovation should not be inhibited by standard-setting and because auditors are delivering the audit service, they know first-hand innovation possible if such innovation were permitted by the standards.

Q29. 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?

Q30. 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?

Response: Auditors currently have a responsibility to address the entity's compliance with laws and regulations that either directly or indirectly effect the financial statements. The auditor however, cannot be held responsible for detecting violations of law or regulation by an entity that have only an immaterial impact on the entity's financial statements.

Q32. 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?

Response: We believe that current auditing standards, in principle if not explicitly, and regardless of the requirements of law, require auditors to assure that that dividends are being properly paid out of surplus and to perform work sufficient to obtain reasonable assurance that the financial statements prepared by the company present a fair and true view in accordance with the applicable financial accounting framework. In many jurisdictions, including the United States, the requirements for "listed companies" do go further since a report on internal control is a required part of an audit of the financial statements of a public company. Internal control includes controls that the entity has designed and placed in operation to prevent or detect and correct violations of law or regulation to which they are subject, including maintenance of adequate accounting records.

Q33. 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?

Response: While auditors' work is conducted in the public interest, the contractual relationship is with management and those charged with governance. It is also recognized that an audit cannot be undertaken with *individual* user's needs and expectations in mind but rather needs to be considered for users as whole and that in fact, those charged with governance represent users as a whole. The necessity of an annual open assurance meeting indicates that the auditor's report is not sufficient and as such, perhaps a more appropriate question would be how the auditor's report could be enhanced or whether more innovative communication methods might be appropriate?

Q34. Should more of the communication and resulting judgments that occur between the auditor and the audit committee be made transparent to users of the financial statements?

Response: We believe that ultimately the responsibility rests with the entity and those charged with governance to determine the nature and extent of information provided publicly to the

entity's own stakeholders. Aside from the auditor's report, auditors should not be the original source of disclosure of discussions in which management of the entity and those charged with governance participated. A very real concern also is that public disclosure of such discussions could have a potentially chilling effect on the robustness of discussions that occur between the auditor and the audit committee.

Q35. 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?

Response: We believe that auditing standard-setters have deliberated this matter extensively. If a key audit matter (KAM) still exists in a subsequent period, it should be reported from year to year and the verbiage reviewed for currency and relevancy. However, the concern is that if a KAM reported one year and not reported the next year requires an explanation of why the KAM went away, we would proffer that that would result in an inappropriate piecemeal opinion that could mislead the user. The risk of inappropriate perceptions could possibly outweigh additional reporting,

Q36. 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?

Response: Our response is in the context only of international auditing standards. To be clear, in accordance with extant auditing standards, the auditor *is* responsible for designing audit procedures to detect material misstatements of the financial statements whether due to error *or* fraud. The question then becomes whether users expect the auditor to also detect immaterial fraud and whether that is a reasonable expectation. If detection of immaterial fraud were deemed an appropriate expectation, auditing standards would need be amended to allow for a more forensic type of audit. Auditor's use of emerging technology, tools and techniques could be used in a more forensic oriented audit, but auditors would then need to be required to use such tools for consistency across audits and the cost of such requirements would need to be carefully considered. Ultimately, the cost of a more forensic audit would require an economic analysis of the impact on both challenger firms and the cost passed on to users of the financial statements.

Q37. Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?

Response: We do not believe that auditing standards on their own can establish a mindset. That is, auditing standards are words that can tell the auditor to have an appropriate mindset, but words alone cannot establish an appropriate mindset. An appropriate fraud detection mindset requires an appropriate "tone" to be set by the audit firm, its leadership and the engagement partner so that the combination of the words in an audit standard and demonstrated tone at the top result in an appropriate fraud detection mindset. As such, we do not consider the existing auditing standards to be deficient in establishing mindset.

Q38. Would it be possible to devise a ‘reasonable person’ test in assessing the auditor’s work in relation to fraud detection?

Response: A ‘reasonable person’ test is only effective when applied in hindsight. Fraud detection often involves following the clues, identifying irregularities and asking questions until satisfied; this process would be very difficult to recreate as part of a ‘reasonable person’ test.

Q39. Should auditors be required to evaluate and report on an audited entity’s systems to prevent and detect fraud?

Response: We believe that if entity management is required to describe its systems to prevent and detect fraud in a report, then auditors could be required to evaluate and report on the entity’s system. A possible model for this reporting is the AICPA *SOC for Cybersecurity* service. Briefly, in a *SOC for Cybersecurity* engagement, management of an entity describes its processes and controls in place to detect, respond to, mitigate and recover from breaches and other security events and using established criteria, the practitioner then reports on the design of the entity’s systems and controls and its effectiveness.

Q40. Is the audit profession’s willingness to embrace change constrained by their exposure to litigation?

Q41. If there were a quantifiable limit on auditor liability, how might this lead to improvements in audit quality and/or effectiveness?

Response: As with any profession or business, exposure to litigation is a concern of audit firms. The subjectivity of the subject matter being reported on by auditors is key to the degree of exposure to litigation audit firms accept. The more subjective the subjective matter on which the auditor reports, the more second guessing of the auditor’s conclusions by users can take place and at some point, the increase in exposure to litigation leads to an unwillingness to participate in the audit market. If liability limits were in place [or safe harbors?], auditors would be more willing to report on subjective subject matters and the value of auditors reporting on expanded subject matters would be greatly enhanced.

Q42. 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?

Response: If the auditor has failed to perform an audit in accordance with the applicable auditing standards or not performed the work with due care, then “yes” auditors should be potentially liable to anyone who uses their work in good faith.

Q43. How might quality of the audit product be improved if the approach to liability was altered, and what reform might enable the most favourable quality improvements?

Response: The current liability regime for audits of financial statements is appropriate. However, for expanded reporting by auditors that would address an entity’s governance, internal control, societal role, and other non-financial information (i.e., more subjective subject matters),

the product would be improved by safe harbors afforded to auditors for open and free reporting of subjective judgments made by auditors. Limits on auditor liability and safe harbors extended could vary based on the nature of the subject matter upon which the auditor would report.

Q45. How far is new technology actually used in audits today? Does the use of technology enable a higher level of assurance to be given?

Q46. In what way does new technology enable assurance to be given on a broader range of issues than is covered by the traditional audit?

Response: The auditor is already required to obtain reasonable assurance in order to express the auditor's opinion. Reasonable assurance is a high but not absolute level of assurance.

Notwithstanding the expanded use of emerging technology by auditors, requiring the auditor to obtain more than reasonable assurance is not supportable. While use of technology can enhance the auditor's analyses of certain information, ultimately professional skepticism must be exercised and human professional judgments need to be made about the output of technology-enabled analyses and estimates made by management and as such, absolute assurance is not obtainable.

Traditionally, the primary source of evidence for auditors was the entity's internally generated or acquired information and most of that information was produced by the entity's financial reporting system. Today, the sources of information available to the auditor have greatly expanded and included many more external information sources. Technology enables the auditor to access information from multiple sources and synthesize such information to enable meaningful conclusions to be drawn. In this manner, technology can enable expanded auditor reporting over a broader array of issues than the traditional financial statement audit.

In the US, the Auditing Standards Board (ASB) currently has a standard-setting project underway related to audit evidence. The objective of the ASB's audit evidence project is to modernize the auditing standards to provide a more robust framework under which the auditor evaluates the sufficiency and appropriateness of audit evidence notwithstanding the source from which information is obtained or the procedure, tool or technique used to obtain information. Additionally, the AICPA and CPA Canada are jointly exploring the impact of automation and Artificial Intelligence (AI) on the assurance profession.

Q47. Are there aspects of current audit procedures or output that are no longer necessary or desirable?

Response: No, we believe the audit is fit for purpose and of value to an effectively functioning global economy.

Q52. Would interaction between shareholders and auditors outside the AGM be practical and/or desirable?

Response: Please refer to our response to Q33 above.

Q53. 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?

Response: We do not believe that an audit can be designed to address specific concerns of individual shareholders as being responsive to one shareholder's concerns may be averse to another shareholder's concerns. If audit were designed to address individual shareholder concerns, would direct auditor liability to a shareholder be established? And, would the audit quickly become cost prohibitive? We believe that ultimately, those charged with governance of the entity and the entity's audit committee are responsible for addressing shareholder concerns and responding appropriately.

Q55. In what way would it be possible for auditors to report on the culture of the entity whose financial statements are being audited?

Response: An entity's culture is not defined in this question (i.e., culture involved with financial reporting or culture involved with hiring practices, for example) but for purposes of responding to this question we are assuming culture as it relates to reporting to its stakeholders. Currently in the context of reporting to its stakeholders, the entity's culture is addressed under the Control Environment component of the COSO internal control framework (i.e., "tone at the top"). If in performing an audit the auditor has concerns about the entity's culture or tone at the top and it is considered to significantly impact the audit, the auditor could reflect this matter as a Key Audit Matter in the auditor's report in accordance with ISA 701, and if the entity's culture is not appropriate then the auditor would report this deficiency as being a significant deficiency in the entity's internal control over financial reporting. As stated previously, expanded reporting by auditors with regard to an entity's culture may be feasible but would necessitate extension of safe harbors to the auditor and possibly limits of liability specifically with regard to this subject matter.

Q56. How can auditors demonstrate that appropriate skepticism has been exercised in reaching the judgments underlying the audit report?

Response: A question is to whom the exercise of appropriate skepticism needs to be demonstrated? With respect to users of the auditor's report, matters where significant professional skepticism was exercised might be communicated as Key Audit Matters (KAMs) at least for audits of listed entities. However, the auditor's report cannot possibly describe the entire thought process undertaken in sufficient detail to provide users with an accurate picture.

Regulatory oversight or inspection is likely the most appropriate mechanism for assessing whether appropriate skepticism has been exercised by an auditor. In this regard, audit documentation is critical to demonstrating the exercise of appropriate professional skepticism.

Q60. Is the profitability of the audit function sufficient to sustain a high-quality audit industry?

Response: We believe that sustaining or enhancing a high-quality audit profession requires audit firm investment in innovation and technology and thus profitability is key to the future as the source for investment in innovation.

Thank you for the opportunity to comment on this Consultation Paper. If you have any questions regarding the comments in this comment letter, please contact our Chief Auditor, Bob Dohrer, at bob.dohrer@aicpa-cima.com.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Barry C. Melancon". The signature is fluid and cursive, with a long horizontal stroke at the end.

Barry C. Melancon, CPA, CGMA
President & CEO, American Institute of CPAs
CEO, Association of International Certified Professional Accountants