

Brydon Review Secretariat  
Sir Donald Brydon  
[brydonreview@beis.gov.uk](mailto:brydonreview@beis.gov.uk)

Brussels, 14 June 2019

**Subject: Independent review into the quality and effectiveness of audit: call for views**

Dear Sir Donald,

Accountancy Europe is pleased to respond to your 'Independent Review into the Quality and Effectiveness of Audit' (the Review). As the umbrella organisation for 51 professional accountancy bodies, including 6 from the UK, we represent 1 million professional accountants, auditors and advisors in 36 countries.

We set out our main points in this letter. In the Appendix, you will find our response to the Review's relevant chapters. Hereby we also draw on our knowledge of European and international regulatory frameworks and we share national good practices. We have also led a European debate on the future of audit and assurance since 2014, see <https://www.accountancyeurope.eu/tag/future-audit-assurance/>.

The audit profession has already started a journey to change and is looking forward to a fruitful dialogue with all its stakeholders and is willing to proactively contribute to develop its future role. A healthy profession benefits society. As the audit market is global, the discussion on the audit's future in the UK cannot be considered in isolation. We strongly encourage global coordination and cooperation on changes in reporting models, company's responsibilities and auditor's roles to avoid different expectations on global markets and within international groups.

**Digitalisation and sustainability demands**

Audit firms are investing heavily to meet changing demands. Digitalisation and sustainability impact business worldwide and effect the auditor's role within the economy. Digitalisation within companies enables the audit to digitalise which can improve audit quality. Auditors can also contribute to add trust to the world of algorithms and artificial intelligence. Sustainability and the impact of climate change create risks and opportunities for companies which start to seek assurance over new performance measures, including non-financial reporting.

We are convinced that financial reporting remains a key input for stakeholders to assess companies' financial prospects and viability. Therefore, the financial statements' audit remains a cornerstone for the audit profession. We also fully recognise the wider needs for corporate information beyond financial reporting, to cover more non-financial reporting, including forward-looking information, governance structures, internal control and risk management systems.

**Reporting, assurance and communication need to adapt**

The audit profession can respond constructively to these needs and change by providing assurance on a wider set of reporting. We also support that auditors (and management) provide more meaningful and transparent reporting to a wider audience, including the public. Since 2015 we have provided thought leadership on the future of corporate reporting, including non-financial reporting and assurance, see <https://www.accountancyeurope.eu/tag/future-corporate-reporting/>.

We note that in the current one-size-fits-all model for reporting, auditing, assurance and communication, it is difficult to align the demands of stakeholders (e.g. investors, creditors, employees, regulators) for all types of companies. Reasons for that could be that the stakeholders themselves are diverse, with highly diverse needs, or indeed, are different for different types of companies (in sector, size, and public interest dimension).

Ultimately, the way forward might be to add an approach to the common core of reporting, auditing, assurance and communication. Namely, an approach that combines:

- diversified stakeholder-demand-driven reporting for different types of companies
- diversified stakeholder-demand-driven auditing and assurance for different types of companies

A framework or standards to expand reporting, assurance and communication in such a way will be needed. A proportionality test or a cost/benefit analysis should also be conducted to determine which way, or how far, to go in expanding the current reporting, assurance and communication approach. It is crucial to avoid unintended consequences on smaller companies and smaller audit firms with a more limited public interest angle.

### **Multidisciplinary firms**

In today's complex economy, the audit of financial statements requires to combine a variety of different knowledge and expertise to perform high quality audits. Providing additional assurance will require even more to intermingle skills and experience of professionals from both audit and other expert backgrounds. For example, experts in corporate social responsibility (CSR), environmental, social and governance (ESG), IT and systems, and engineers. Bringing together this diversified expertise within a multidisciplinary firm is a prerequisite to deliver quality audit and assurance services which respond to companies' complex and evolving business models. Having this multidisciplinary expertise within the audit firm is the only way to ensure full compliance with quality standards and independence requirements.

### **Expectation gap: knowledge, performance and evolution**

We recognise that there is an expectation gap that needs to be dealt with. This expectation gap consists of three gaps which are linked: the knowledge gap, the performance gap and the evolution gap (see Appendix). Many of our proposals below are expected to at least partly mitigate these different expectation gaps. Auditors have started by better communicating, explaining what they did, how they did it and what they found. Key Audit Matters reporting does this on an audit engagement level. Other stakeholders in the corporate reporting chain could do more.

### **Audit quality**

We need to look at audit quality in a more holistic and pragmatic way. It is equally about auditors' competences and expertise in exercising professional judgement and scepticism, meeting stakeholders' demands and applying the principles and requirements set by standards, laws and regulation. We agree with the Review that the main focus should be on the audit output in meeting the legitimate demands of those for whom the auditor's report is intended, and not primarily on inspections.

### **Legal responsibility**

To effectively improve reporting and auditing to reduce the risk of future corporate failures, it is indispensable to assess the entire chain of corporate governance, corporate reporting and frameworks applicable for companies. Next to auditors' responsibilities, company's management and directors' responsibilities and accountability for reporting need to be enhanced and clarified. This includes their related liability and any potential sanctions in case of non-compliance. Companies' and auditors' responsibilities also need to be aligned, as ordinarily, auditors only report on information which the company has already reported on.

### **Liability**

Expanding companies' reporting and their directors' responsibilities requires reconsidering their liability. Equally, expanding the scope of audit and assurance and auditors' responsibilities and accountability necessitates addressing how this impacts auditors' wider duty of care and liability. Liability rules should be adapted to the subject matters assured which is expected to widen the scope of assurance and competition in the market. Different audit liability regimes exist across European countries (see Appendix). We have not found evidence that these differences result in significant variations in audit quality across Europe.

## Assessing directors' going concern and non-financial disclosures

We believe that companies' directors should take the responsibility to include more detailed and considered disclosures in their annual report on their going concern assumptions (short term) and on the (longer term) key business risks that impact the business' viability. It would be feasible to also further extend the auditor's role and assurance to cover these statements on companies' health and other forward-looking information. A framework, including more detailed requirements and procedures, would need to be developed for this. This has already happened in some European countries (see Appendix).

Wider reporting by companies' management and assurance by the auditors can be communicated in different ways, for instance publicly, or via private reporting to the company's directors or to financial supervisors. Such a private reporting model could for instance be applied for further risk management and internal controls reporting and assurance.

## Communicating audit findings

In respect of communicating the audit findings, we acknowledge that reporting Key Audit Matters (KAMs) is experimental and should be further innovated. For instance, updating KAMs featured in the previous audit report could be envisioned. Graduated findings as defined in the Review could also be further developed on KAMs.

The auditor's role at the annual general meeting (AGM) of public interest entities and large privately held entities could be reconsidered within the appropriate legal framework. In certain countries there is already further dialogue between auditors and shareholders at AGMs to demonstrate the audit's value and relevance, mostly focused on explaining the audit report and its KAMs. The audit committee's potential additional role for further communicating on their supervision of the auditors, either in writing or orally at the AGM, should be further explored as well.

## Fraud

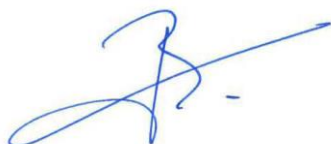
Related to preventing and detecting fraud within a company, the importance of well-functioning risk management and internal control systems cannot be stressed enough. Using technology is also well embedded in forensic procedures that experts perform that are often brought in if fraud, or other issues, are suspected. This comes at a cost, often a significant one.

Most expect that technology can help to improve fraud risk assessments. For example, by enabling reviewing the entire population of transactions rather than just samples of it. This is expected to eventually contribute to providing better audit and assurance services around detecting fraud. Accordingly, the accountancy profession plans to keep developing data analytics tools and adapt skillsets needed for this area.

We continue to be committed to enhance audit quality. All key stakeholders in the corporate governance and reporting system, including companies' management, directors and audit committees, have a responsibility to strengthen corporate reporting, auditing and assurance related to risk management, internal controls and companies' going concern, viability and fight against fraud.

We thank you for the opportunity to comment. For further information on this letter, please contact Hilde Blomme on +32 (0) 2 893 33 77 or via email at [hilde@accountancyeurope.eu](mailto:hilde@accountancyeurope.eu).

Sincerely,



Olivier Boutellis-Taft  
Chief Executive



Florin Toma  
President

## **ABOUT ACCOUNTANCY EUROPE**

Accountancy Europe unites 51 professional organisations from 36 countries that represent **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

Accountancy Europe is in the EU Transparency Register (No 4713568401-18).

## APPENDIX

### CHAPTER 1: DEFINITIONS OF AUDIT AND ITS USERS

#### *Other key points*

Accountancy Europe demonstrated in its Paper on the ‘Future of Corporate Reporting’<sup>1</sup> that there are needs for different types of corporate information to be disclosed. These needs have broadened the content of corporate reporting from merely financial reporting to also cover non-financial reporting. The latter includes reporting on sustainability and longer-term value drivers, prospects and risks, including a company’s impact on the environment and on society.

We have also noted that there is a growing audience for corporate reporting, evolving from shareholders over stakeholders to society at large.

This trend of increasing demands from investors and other stakeholders also applies to the needs for audit and assurance on corporate reporting.

There are a number of obstacles to this evolution. Financial reporting is a mature process within most companies, using robust reporting frameworks like International Financial Reporting Standards (IFRS) or national Generally Accepted Accounting Principles (GAAP). However, the processes, systems and controls used by many corporates to prepare their non-financial reporting are less developed and still evolving, using a very wide range of non-financial reporting frameworks<sup>2</sup>. Therefore, many companies might not be ready for audit or assurance covering their non-financial reporting.

Currently, International Standard on Assurance Engagements (ISAE) 3000 on ‘Assurance Engagements Other than Audits or Reviews of Historical Financial Information’ does not cover dealing with assertions based on forecasts, longer-term and future-oriented information and narratives. An assurance framework including more detailed requirements and procedures would need to be developed for this.

In respect of users’ needs and the outcome of audit and assurance, it is also important to reflect on the linkage with an extended legal duty of care or liability of auditors. We refer to our responses in Chapter 9 on Auditor liability.

### CHAPTER 2: THE ‘EXPECTATION GAP’

#### *Other key points*

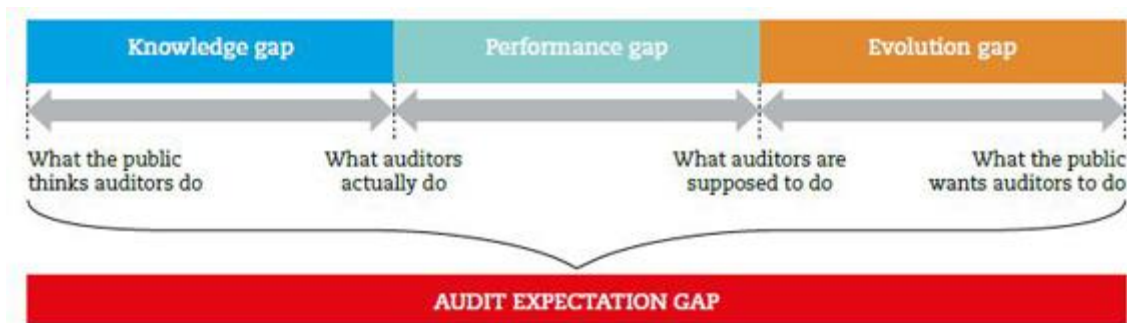
A recent Association of Chartered Certified Accountants (ACCA) report<sup>3</sup> notes that there are different gaps which are linked: the knowledge gap, the performance gap and the evolution gap. The report indicates that the knowledge gap can make it harder to understand the true evolution gap, for example if the public is unaware of policies that are already in place. The performance gap focuses on areas where auditors do not do what auditing standards or regulations require. This could be because of insufficient focus by the audit firm on audit quality or due to differences in how practitioners and regulators interpret auditing standards.

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<sup>1</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/FEECogitoPaper -  
\\_FutureofCorporateReporting.pdf](https://www.accountancyeurope.eu/wp-content/uploads/FEECogitoPaper_-_FutureofCorporateReporting.pdf)

<sup>2</sup> See <https://www.accountancyeurope.eu/wp-content/uploads/170918-Call-for-action-letter.pdf>

<sup>3</sup> See May 2019 ACCA report on Closing the expectation gap in audit: [https://www.accaglobal.com/content/dam/ACCA\\_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf](https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf) as from page 9



Interesting evidence can be found in this ACCA survey<sup>4</sup> which reveals the expectation that auditors should evolve to prevent company failures. 55% of the public worldwide believe auditors “could prevent company failures”:

- 55% believe it is auditors who are responsible for avoiding company failures
- 34% expect auditors to always detect and report any fraud
- 70% believe audit should evolve to prevent company failures.

In addition to better auditor communication, we support any initiatives to decrease or solve these knowledge, performance and evolution gaps in the public interest. In addition, all participants in the corporate reporting chain have a role to play to address the expectation gap.

## Question 6

*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?*

The following initiative to enhance the level of transparency on audit quality might be considered. In 2016, we did a survey on Audit Quality Indicators<sup>5</sup> which included audit quality indicators (AQIs) which have been developed by nine different organisations worldwide, including regulators, oversight bodies, professional bodies, and audit firms. It also provides insight into key differences between these AQIs; namely, if they are rules or principles-based, qualitative or quantitative, and whether reporting on these AQIs is made public or kept private.

We wanted to add a European perspective to the global discussion on audit quality. AQIs can increase comparability and transparency between audits and audit firms. As audits are dealt with on a global level, an international initiative on AQIs would be the best way forward. For this to materialise, the different international stakeholders including the audit profession would need to collaborate in order to agree on a globally accepted set of AQIs.

We also refer to our responses to Chapter 5.

## CHAPTER 3: AUDIT AND WIDER ASSURANCE

### *Other key points*

As we already indicated, financial reporting remains crucial for stakeholders. In addition, the focus of an ever-wider range of stakeholders is gradually expanding from financial reporting to wider corporate reporting including both financial and non-financial information. Therefore, the linkage of financial and non-financial information reporting should be improved.

<sup>4</sup> See article by Helen Brand, ACCA CEO on the ACCA survey on Closing the expectation gap in audit: <http://www.cityam.com/277680/increased-scrutiny-profession-its-time-auditing-public>. The ACCA survey included 11,000 people in 11 countries around the world (including in Australia, Canada, Czech Republic, Greece, Malaysia, the Netherlands, New Zealand, Singapore, South Africa, UAE and the UK)

<sup>5</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/1607\\_Update\\_of\\_Overview\\_of\\_AQIs.pdf](https://www.accountancyeurope.eu/wp-content/uploads/1607_Update_of_Overview_of_AQIs.pdf)

In addition to the financial statements being audited, it starts to be more and more common for all or some parts of the non-financial information like sustainability, ESG and CSR reporting to benefit from a certain level of assurance. The related auditor's reporting could form part of the audit report, but it could also be issued as a separate assurance report.

In case Non-Financial Information (NFI) is 'assurable' as per the characteristics of any assurance engagement, and if there is a market or other demand, the audit profession can respond to this call with relevant skills for multidisciplinary teams, appropriate standards and proven experience to deliver quality. In addition, we believe that the audit profession is particularly well placed to respond to such demands because of our profession's observance of ethical requirements as well as quality control or quality management rules and standards. We expand on some of the challenges related to this in our response in Chapters 1 and 4.

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## Question 7

*What should be the role of audit within wider assurance?*

Before getting into the need for audit and assurance, we have to acknowledge that the focus of an ever-wider range of stakeholders is gradually expanding attention from financial reporting to wider corporate reporting, including non-financial information, for instance:

The International Organisation of Securities Commissions (IOSCO) issued in January 2019 a Statement on Disclosure on ESG Matters by Issuers<sup>6</sup>. IOSCO added: *"At the same time, some investors have expressed the desire for enhanced reliability and comparability of ESG information and disclosures, in order to facilitate a more accurate assessment of risk and, accordingly, more informed investment decisions."*

Chartered Financial Analysts (CFA) Institute found in a 2017 Environmental, Social and Governance (ESG) Survey<sup>7</sup> an increasing interest in independent assurance and/or audit on ESG Reporting.

The European Securities and Market Authorities (ESMA) announced in October 2018 that European Enforcers will focus on new IFRSs and NFI in issuers' 2018 Annual Reports<sup>8</sup>. The latter is a first for ESMA. No specific reference to audit or assurance was made, probably because ESMA is not the competent European Authority for this.

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## Question 8

*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?*

We refer to our work on 'interconnected assurance' on 'Core and More reporting'<sup>9</sup>. We included two testimonials of companies that applied our 'Core and More' reporting concept (our 'integrated reporting' concept) and obtained 'interconnected assurance' (our term for mixed or integrated assurance) on it. These companies are Generali, an Italian insurance group, and ABN Amro Bank, a Dutch banking group.

We also refer to our work over the last few years on assurance on NFI reporting<sup>10</sup> which demonstrates the accountancy profession skills in this area.

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<sup>6</sup> See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf>

<sup>7</sup> See <https://www.cfainstitute.org/-/media/documents/survey/esg-survey-report-2017.ashx>

<sup>8</sup> See <https://www.esma.europa.eu/press-news/esma-news/european-enforcers-focus-new-ifrss-and-non-financial-information-in-issuers%E2%80%99>

<sup>9</sup> See <https://www.accountancyeurope.eu/wp-content/uploads/180724-Core-and-more-success-online.pdf> as from page 2

<sup>10</sup> See on the right side in <https://www.accountancyeurope.eu/reporting-transparency/the-future-of-corporate-reporting/>

We also refer to our work on differing levels of assurance in relation to corporate governance statements<sup>11</sup>. We demonstrated that the level of assurance can vary depending on the different subject matters on which assurance is provided and how the auditor could report in such circumstances.

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## Question 9

*Are the existing boundaries between internal and external audit clear?*

As far as the reliance by external auditors on the work of internal auditors is concerned, in continental Europe, ISA 610 as issued by the International Audit and Assurance Standards Board (IAASB), which is already quite restrictive, applies<sup>12</sup>. This standard does not prohibit such reliance as in the UK. We have not found evidence that this would have caused any issues. We also refer to our response to Question 13.

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## Question 10

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

We refer to our response to Question 9. Below, we also refer to German good practice related to assurance around internal control systems.

We also refer to the German Institut der Wirtschaftsprüfer (IDW) Assurance Standard 'Principles of due diligence on the internal audit systems' (IDW AsS 983). It was issued on 3 March 2017 and became effective on 30 April 2017<sup>13</sup>.

This standard is frequently used by German auditors of predominantly larger companies to provide a reasonable assurance conclusion in voluntary assurance engagements relating to internal audit systems. The audit committee, or if there is no audit committee then the supervisory board, is responsible for the internal audit system. The standard uses the architecture of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Enterprise Risk Management Framework as the basis for corporate governance systems. The standard defines internal audit as an essential function in corporate governance and as a 'third line of defence'. Assurance according to this standard must cover all the binding elements of internal audit. Assurance of separate elements is not in the scope of this standard. The report does not make a statement of whether the internal audit system is free of errors. The standard is consistent with ISAE 3000. The auditor's assurance report is not public, it is presented to the company's management, supervisory board and/or audit committee.

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<sup>11</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/DP\\_Assurance\\_on\\_Corporate\\_Governance\\_Statements\\_0911\\_Colour20112009541533.pdf](https://www.accountancyeurope.eu/wp-content/uploads/DP_Assurance_on_Corporate_Governance_Statements_0911_Colour20112009541533.pdf) as from page 43

<sup>12</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/MA\\_ISA\\_in\\_Europe\\_overview\\_150908\\_update-2.pdf](https://www.accountancyeurope.eu/wp-content/uploads/MA_ISA_in_Europe_overview_150908_update-2.pdf). Since issuance of this paper in 2015, Portugal and Germany have adopted the ISAs.

<sup>13</sup> The standard can be obtained in German from the IDW on simple demand.



## CHAPTER 4: THE SCOPE AND PURPOSE OF AUDIT

### *Risk and internal controls*

#### *Other key points*

It is up to company's management, non-executive directors and the audit committee to make sure the company has the right risk management and internal controls systems and processes, that these are effective and that they are properly documented. We therefore believe it is right that their responsibilities and accountability throughout the whole corporate reporting chain are reconsidered.

We are supportive of companies reporting more explicitly on risk management and internal controls. This can be done in different ways, for instance publicly or via private reporting to company directors, financial supervisors and other competent authorities.

The next question is whether the auditor should perform further work on such extended reporting on risk management and internal controls and whether they should report on the outcome of such work, in addition to the current private auditor's reporting to audit committees. The auditor could perform further work on such extended reporting on risk management and internal controls. In case of further auditor reporting on such work, it should be private as we need to bear in mind that it is management and not the auditor who is primarily responsible for providing reliable and accurate information about the company.

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### Question 12

*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 believe that directors should make a more explicit statement in respect of risk management and internal controls. This could be done in different ways. As far as assurance by auditors on such statements, we refer to German good practice below.

We refer to the German IDW Assurance Standard 'Principles for the Proper Performance of Reasonable Assurance Engagements Relating to Risk management Systems' (IDW AsS 981). It was issued on 3 March 2017 and became effective 30 April 2017<sup>14</sup>.

This standard is frequently used by German auditors of predominantly larger companies to provide a reasonable assurance conclusion in voluntary assurance engagements relating to risk management systems. The standard can be used to plan, perform and report on such engagements. The audit committee, or if there is no audit committee then the supervisory board, is responsible for the risk management system. The standard uses the architecture of the COSO Enterprise Risk Management Framework as the basis for corporate governance systems. The report does not give a conclusion on whether all risks are identified and addressed, nor does it enable a conclusion to be expressed about a company's ability to continue as a going concern. It is consistent with ISAE 3000. The auditor's assurance report is not public, it is presented to the company's management, supervisory board and/or audit committee.

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### Question 13

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

We refer to German good practice related to assurance on the internal control system of reporting.

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<sup>14</sup> The standard can be obtained in English from the IDW on simple demand.

We refer to the German IDW Assurance Standard 'Principles for the Proper Performance of Reasonable Assurance Engagements on the internal control system of internal and external reporting' (IDW AsS 982). It was issued on 3 March 2017 and became effective on 30 April 2017<sup>15</sup>.

This standard is frequently used by German auditors of predominantly larger companies to provide a reasonable assurance conclusion in voluntary assurance engagements relating to internal control systems of internal and external reporting. The audit committee, or if there is no audit committee then the supervisory board, is responsible for the internal control system. The standard uses the architecture of the COSO Enterprise Risk Management Framework as the basis for corporate governance systems. The standard requires examination of all the basic elements of internal control. Examinations of separate elements are not in the scope of this standard. The assurance report does not make a statement of whether the reporting on internal control system is free of errors. The standard is consistent with the ISAE 3000. The auditor's assurance report is not public, it is presented to the company's management, supervisory board and/or audit committee.

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## Question 14

*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?*

We issued a publication on 'Auditor Reporting on Key Audit Matters (KAMs) in the European Banking Sector'<sup>16</sup>. Our sample of financial institutions surveyed included 62 financial institutions, including 5 UK ones, for 2017, the first year of the European and international KAM reporting requirement. We found that 61% of the audit reports included a KAM on IT Systems, which are closely related to internal controls, and that KAMs on IT Systems represented 14% of the total KAMs reporting in audit reports issued on 2017 financial statements. This makes it the second most popular KAM in 2017 in our sample.

In 2018, based on a partial sample of 28 of these 62 financial institutions, we found that 82% of the audit reports included a KAM on IT Systems and that KAMs on IT Systems represented 18% of the total KAMs reporting in audit reports issued on 2018 financial statements. This makes it the most popular KAM in 2018 in our sample.

Based on this, we would conclude that in the case of a significant assessed risk of material misstatement, also related to internal controls, auditors would already include a KAM in their public audit report.

## CHAPTER 4: THE SCOPE AND PURPOSE OF AUDIT

### *Going concern, viability and unaudited forward-looking information*

#### *Other key points*

Any debate as to the provision of information about a company needs to bear in mind that it is the company's management and directors and not the auditor who is primarily responsible for providing reliable and accurate information about the company<sup>17</sup>.

As the primary responsibility for assessing whether a company is a going concern lies with the directors, we would recommend that more detailed and considered disclosures should be required from the directors to explain why they believe the company is a going concern. Part of the problem lies in the accounting standards which present a low hurdle for a company to be classified as a going concern.

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<sup>15</sup> The standard can be obtained in German from the IDW on simple demand.

<sup>16</sup> See page 7 of [https://www.accountancyeurope.eu/wp-content/uploads/Accountancy\\_Europe\\_KAMs\\_2018.pdf](https://www.accountancyeurope.eu/wp-content/uploads/Accountancy_Europe_KAMs_2018.pdf)

<sup>17</sup> Derived from page 3 of [https://www.accountancyeurope.eu/wp-content/uploads/BP\\_110630\\_-\\_Auditing\\_-\\_Developing\\_the\\_Role\\_of\\_the\\_Auditor\\_and\\_Auditors\\_Communication.pdf](https://www.accountancyeurope.eu/wp-content/uploads/BP_110630_-_Auditing_-_Developing_the_Role_of_the_Auditor_and_Auditors_Communication.pdf)

We believe that companies could include more details in their annual report on their going concern assumptions in short term and more details on the key business risks that impact the business's viability in the longer term<sup>18</sup>.

There is a need to develop detailed requirements and procedures, a so-called framework, for this reporting by the company. The same is needed if the auditor's role would be expanded.

It might be feasible to further extend the auditor's role and assurance to cover statements made by a company's management - as included in the annual report - in relation to companies' financial health and other forward-looking information<sup>19</sup>.

However, any decision as to whether this could be part of the statutory audit or part of a separate engagement would need further consideration on how the challenges to achieve this can be overcome. Currently, ISAE 3000 on 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information' does not cover dealing with assertions based on forecasts, longer-term and future-oriented information and narratives. The current IAASB Consultation on the extended External Reporting (EER) Assurance<sup>20</sup> (phase 1) does not provide guidance on this, this will be developed in phase 2.

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## Question 15

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

The Nederlandse Beroepsorganisatie van Accountants (NBA, our Dutch member body) issued in December 2018 a proposal called 'More relevant, not more risky' to extend the auditors' responsibilities related to communication on going concern assumptions<sup>21</sup>.

It is based on the acceptance of criticism that the current company's and auditor's communication related to going concern assumptions and issues is insufficient. It considers that this is because only very considerable uncertainties will eventually (too late) be raised publicly, as the 'red flag' stigma leading to a self-fulfilling prophecy is massive (no smoke without fire effect).

NBA therefore proposes for every company to have the company include a 'future-proof paragraph' in the management report on risks, uncertainties, assumptions on short term (one year) and longer term, which is quantitatively based.

NBA also proposed that every audit report makes an explicit reference to these future-proof paragraphs.

The purpose is to achieve a level playing field for all companies and all auditor's reporting on going concern assumptions and issues. As an aside, it is also stipulated that work is needed to have more timely reporting, for instance by better enforcement of the publication of management reports.

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## Question 16

*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"?*

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<sup>18</sup> See page 3 of [https://www.accountancyeurope.eu/wp-content/uploads/BP\\_110630 - Auditing - Developing the Role of the Auditor and Auditors Communication.pdf](https://www.accountancyeurope.eu/wp-content/uploads/BP_110630_-_Auditing_-_Developing_the_Role_of_the_Auditor_and_Auditors_Communication.pdf)

<sup>19</sup> See pages 3 and 4 of [https://www.accountancyeurope.eu/wp-content/uploads/BP\\_110630 - Auditing - Developing the Role of the Auditor and Auditors Communication.pdf](https://www.accountancyeurope.eu/wp-content/uploads/BP_110630_-_Auditing_-_Developing_the_Role_of_the_Auditor_and_Auditors_Communication.pdf)

<sup>20</sup> See <http://www.ifac.org/system/files/publications/files/EER-Consultation-Paper.pdf>

<sup>21</sup> See <https://www.accountant.nl/contentassets/2c4c2cae2bdd44d594ec1bcc774b3dfe/white-paper-continuiteit-sgpb-dec18.pdf> (in Dutch)

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## Question 17

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

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## Question 18

*Should such a statement be subject to assurance?*

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## Question 19

*Who might be capable of giving such assurance?*

### **French good practice**

We refer to the French 'Procédure d'alerte'<sup>22</sup> or 'early warning procedures' which come in addition to the requirement for the auditor to assess the going concern assumptions (based on the French professional standards which are similar in substance to ISA 570 on Going Concern). If at any stage during the auditor's mandate he becomes aware that there is a material uncertainty about the entity's ability to continue as a going concern, the following legal four stage procedure should be followed:

First stage: if, in the performance of his engagement, the statutory auditor of a company identifies matters that are of a nature that may cast significant doubt on the company's ability to continue as a going concern, the auditor should write a letter to the chairman of the board of directors or the executive board chairman as prescribed in French regulation.

Second stage: if no reply is received within fifteen days or if the reply received does not enable to demonstrate that the company is in a position to continue as a going concern, the statutory auditor should request the chairman of the board of directors or the executive board chairman, in a letter copied to the president of the commercial court, to have the board of directors or the supervisory board convened to discuss the matters raised. The statutory auditor should be invited to that meeting. The minutes of the board of directors' meeting or supervisory board meeting should be sent to the president of the commercial court and to the workers council or, if no workers council, to the employees' representatives.

Third stage: if the board of directors or the supervisory board have not been convened to discuss the matters raised or if the statutory auditor has not been convened to this meeting or if the statutory auditor considers that the company remains unable to demonstrate it is in a position to continue as a going concern despite the decisions taken by the board, a shareholders general meeting should be convened under conditions, and within a time limit, determined in French regulation. The statutory auditor should issue a special report which is presented to the shareholders. That report is also sent to the workers council or, if no workers council, to the employees' representatives.

Fourth stage: if, after the shareholders general meeting, the statutory auditor finds that the decisions taken do not demonstrate the company is in a position to continue as a going concern, the auditor should inform the president of the commercial court of his actions and send him his results.

The auditor must thus put in place procedures whereby threats to going concern are reported and acted upon on a timely basis. Depending on the legal form of the entity, the early warning procedure may be a three-stage procedure as well (e.g. for SAS and SARL).

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<sup>22</sup> See the French commercial code in Title III: Provisions common to various commercial companies, Chapter IV: Warning procedures, Article L. 234-1 <https://www.legifrance.gouv.fr/Traductions/Liste-des-traductions-Legifrance> (official translation in English is in the link to the code in the 3<sup>rd</sup> line, right column)

### *German good practice*

We also refer to the German IDW Draft Assurance Standard 'Assurance on the System for Managing Going Concern Risks Pursuant to § 317 Abs. 4 of the German Commercial Code'. It was issued as a consultation paper in June 2019 and is expected to become effective for financial years beginning after the end of 2020<sup>23</sup>.

As part of the risk early recognition system, listed stock corporations in Germany are required to establish an effective going concern Risk Management System. The law (Par. 317 sec. 4 of the German Commercial Code) requires the auditor of these companies to provide an assurance conclusion on the appropriateness and effectiveness of the going concern related risk management systems. The draft assurance standard specifies the planning and performance of the assurance work and the reporting in the long form audit report. In addition, the draft standard provides guidance on the basic elements of such a system that the statutory auditor considers when evaluating the system in place. The draft standard would require the statutory auditor to provide a reasonable assurance conclusion on the appropriateness and effectiveness of the going concern Risk Management System. The long form audit report would be provided to management and the supervisory board/audit committee and would not be a public report.

This will come in addition to what is currently already done in relation to risk management and reporting of risks. German revised accounting standard for management reports (GAS 20) requires corporations in Germany to report material risks (and opportunities) of the entity, including going concern risks, in the statutory management report which is published together with the audited financial statements. An IDW Assurance Standard (IDW AuS 350) requires the statutory auditor to provide a reasonable assurance conclusion on the management report, including on management's risks reporting. The auditor's report includes a specific assurance conclusion on management's risk reporting.

### *European good practice*

We point out that Article 12 of Regulation 537/2014 on 'Statutory Audit of Public Interest Entities'<sup>24</sup> includes a requirement for statutory auditors to report promptly to the national competent authorities any material threat or doubt concerning the continuous functioning of the public-interest entity.

In practice, for regulated industries like financial institutions and insurance undertakings, it is clear which competent authority to report to. For many other companies, that is less the case, which makes this measure less effective.

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## Question 20

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

In three EU Member States<sup>25</sup> the management report, the CSR report, ESG information and the description or effectiveness of the risk management system are currently subject to audit or another level of assurance, whereas in other countries they are not.

NFI reporting can range from describing the future strategy of the business to the forecast of greenhouse gas emissions. There is less credibility around forward-looking information and companies may avoid reporting on negative forecasts or impacts. A challenge exists in dealing with assertions based on longer-term outcome and impact indicators which are future and long-term oriented, overall more narrative and currently less developed. This type of information is not covered by ISAE 3000 and is frequently excluded from the scope of the assurance engagement as currently provided. There is a need for innovative approaches to be able to provide confidence in such information. These innovative approaches will take time to be developed.

To move this forward, further debate with all relevant stakeholders on proposals in this area is needed to balance the information needs of the investor and user community with the potential for disclosing business information that is not detrimental to the commercial interests of the company. A cost/benefit analysis or impact assessment would also be needed. Furthermore, the impact on the liability of all parties involved should be considered. The

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<sup>23</sup> The draft standard, on which consultation is eminent, can be obtained in German from the IDW on simple demand.

<sup>24</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=en>

<sup>25</sup> France, Italy, Spain

audit profession is open to changes, looking forward to a fruitful dialogue with all its stakeholders and is willing to proactively contribute to develop the future role of the auditor.

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## Question 21

*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?*

In practice, assurance engagements are performed on various subject matters, for example, an assurance practitioner can provide assurance on: (i) a full sustainability/CSR report or a part of it; (ii) specific ESG aspects or/and Key Performance Indicators (KPIs); (iii) reporting processes (but not the data itself).

Companies with less mature reporting practices often start with assurance provided for internal purposes only. When the subject matter is internal controls, the initial scope is often set on the design of the controls and, at a later stage, the operating effectiveness of controls can be included. Engaging an assurance practitioner to perform an engagement on a limited number of KPIs is one of the steps that can help companies to identify areas where the robustness of data, systems and processes need improvement. This would ultimately benefit the users.

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## Question 22

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

As required by the European Union Directive 2014/95/EU, large companies have to issue non-financial and diversity information, which includes a brief description of a company's business model on environmental, social and employee-related, and anti-corruption and bribery matters as well as respect for human rights<sup>26</sup>.

The transposition of this Directive in EU countries has paved the way to more consistency in NFI reporting, but it is just the beginning. There is still considerable flexibility about what is reported and how. Such information is reported in different ways in different countries. It can be part of the management report, in the UK part of the Strategic Review, other countries have included it in a separate report. In addition, companies can also issue a variety of separate reports which covers such ESG, CSR or sustainability information.

As included in Directive 2014/95/EU, the NFI reported should be checked by the auditor, but this check is only to make sure that the information is included, it does not provide any assurance that the information can be trusted<sup>27</sup>. Three EU Member States<sup>28</sup> have since decided to embed into law an assurance requirement on such information. This was foreseen as an option in the Directive.

Limited or reasonable assurance can be provided on a selection of KPIs, a full NFI report, or a combination of limited assurance on some KPIs and reasonable assurance on another part of the NFI report. However, given this flexibility, clients and other stakeholders have difficulty in understanding the scope of the assurance engagement.

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<sup>26</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>

<sup>27</sup> See page 10 in <https://www.accountancyeurope.eu/wp-content/uploads/NFR-Publication-3-May-revision.pdf> (revised May 2018)

<sup>28</sup> France, Italy and Spain as of to date

For France see Article L. 225-102-1 in

<https://www.legifrance.gouv.fr/affichCodeArticle.do?idArticle=LEGIARTI000022496405&cidTexte=LEGITEXT00005634379> (in French)

For Italy see

[https://www.gazzettaufficiale.it/atto/serie\\_generale/caricaDettaglioAtto/originario?atto.dataPubblicazioneGazzetta=2017-01-10&atto.codiceRedazionale=17G00002&elenco30giorni=true](https://www.gazzettaufficiale.it/atto/serie_generale/caricaDettaglioAtto/originario?atto.dataPubblicazioneGazzetta=2017-01-10&atto.codiceRedazionale=17G00002&elenco30giorni=true) (in Italian)

## CHAPTER 5: AUDIT PRODUCT AND QUALITY

### *Other key points*

We note that how auditor regulators define ‘deficiencies’ or ‘quality gaps’ in their inspection reports differs significantly from one country to another, also in Europe. The outcome of this is that for instance in the Netherlands, the Dutch audit regulator Autoriteit Financiële Markt (AFM)<sup>29</sup> considers more than half of the audit engagements of the largest audit firms auditing public interest entities to be deficient on one or more accounts. In many other continental European countries<sup>30</sup>, and also the UK (by the current audit regulator, FRC<sup>31</sup>), the percentage of deficiencies reported for the audit firms of the same international networks, with a common system of quality control, is much lower.

We therefore agree with the statement in paragraph 70 of the Review that as far as the audit product and quality is concerned, the main focus should be on the audit output in meeting the legitimate demands of those for whom the auditor’s report is intended, and not primarily on inspections.

We therefore support more meaningful and transparent reporting to the public<sup>32</sup>, without obscuring the current key content of the opinion on the true and fair view given by the financial statements. In light of growing demands for transparency and heightened expectations, the informative value of the audit report must be improved.

We also welcomed the IAASB initiative on enhancing auditor reporting with Key Audit Matters (KAMs) and continue to see its value. We note however that some question whether these changes fulfil expectations.

We observe also that the real effectiveness of an audit continues to rest with the people who apply the procedures, their professional experience and scepticism, matters which are nearly impossible to quantify and disclose. Reference is made to our response to Chapter 7.

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### Question 25

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

In addition to consider updating KAMs featured in the previous audit report, other possibilities related to auditor conclusions have been suggested to make audit reporting more innovative in the future. What should be deliberated further is the introduction of graduated findings on KAMs. In addition, benchmarking could be developed that could be considered in connection with ‘big data’ and ‘data mining’ technologies. This type of reporting would require further consideration, for instance in relation to the development of robust criteria as well as imposing even stricter consistency requirements.<sup>33</sup>

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<sup>29</sup> See <https://www.afm.nl/en/professionals/nieuws/2017/juni/kwaliteitslag-oob>: “The number of statutory audits performed that are qualified as ‘inadequate’ at each of the Big 4 audit firms is too high, similar to the previous regular inspection in 2014. The AFM qualified 19 of the 32 inspected statutory audits as ‘inadequate’: 3 at Deloitte, 4 at PwC and 6 at KPMG and EY”. The 32 inspected audits include both PIE and other audits.

<sup>30</sup> See <https://www.ifiar.org/?wpdmdl=9603>: “IFIAR also tracks the percentage of listed public interest entity audits inspected with at least one finding. The general reduction in this percentage continued in the 2018 survey, reaching 37% (down from 47% when data on this metric was first collected for the 2014 survey)”.

<sup>31</sup> See <https://www.frc.org.uk/news/june-2018/big-four-audit-quality-review-results-decline>: “Overall results from the most recent inspections of *eight firms* by the FRC show that in 2017/18 72% of audits required no more than limited improvements compared with 78% in 2016/17. Among FTSE 350 company audits, 73% required no more than limited improvements against 81% in the prior year”.

<sup>32</sup> See page 9 of [https://www.accountancyeurope.eu/wp-content/uploads/Future\\_of\\_Audit\\_and\\_Assurance\\_Discussion\\_Paper\\_1402.pdf](https://www.accountancyeurope.eu/wp-content/uploads/Future_of_Audit_and_Assurance_Discussion_Paper_1402.pdf)

<sup>33</sup> Derived from page 9 of [https://www.accountancyeurope.eu/wp-content/uploads/Future\\_of\\_Audit\\_and\\_Assurance\\_Discussion\\_Paper\\_1402.pdf](https://www.accountancyeurope.eu/wp-content/uploads/Future_of_Audit_and_Assurance_Discussion_Paper_1402.pdf)

The independent auditors' report of Rolls-Royce Holdings plc<sup>34</sup> is an inspiring example of how the auditor's reports and opinions could further evolve.

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## Question 28

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

Responsiveness to innovation, especially when it comes to digitalisation, are key concepts that need to be taken into account by auditing standard setters<sup>35</sup>. Standards are expected to be responsive to current developments and innovations in the market.

The latest work programme of the IAASB, the international auditing and assurance standard setter, indicates they are starting some initiatives exploring issues related to digitalisation in auditing.

Whether the absence of international standards or guidance related to digitalisation of auditing is due to having up to half of the members of the IAASB being practitioners (called producers in the Brydon Review) is questionable. The entire IAASB standard setting process is after all already under the oversight of the independent Public Interest Oversight Board (PIOB), accountable to public authorities in the Monitoring Group.

## CHAPTER 6: LEGAL RESPONSIBILITIES

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### Question 29

*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?*

In most continental European countries, based on national company law requirements, management and directors make in the financial statements a clear distinction in the reserves between distributable (from realised profits) and non-distributable (from unrealised profits) reserves. This is accounted for either based on IFRS but mostly based on national GAAP. In these countries, this is also audited as part of the statutory audit of the financial statements.

#### *German good practice*

We refer to the German IDW Assurance Standard 'Principles for the Proper Performance of Reasonable Assurance Engagements Relating to Compliance Management Systems' (IDW AsS 980). It was issued on 11 March 2011 and became effective 30 September 2011<sup>36</sup>.

This standard is frequently used by German auditors of predominantly larger companies to provide a reasonable assurance conclusion in voluntary assurance engagements relating to compliance management systems. The compliance management system is a part a company's corporate governance and ensures compliance within the entity. The standard is consistent with the International Framework for Assurance Engagements and the ISAE 3000. The auditor's assurance report is not public, it is presented to the company's management, supervisory board and/or audit committee.

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<sup>34</sup> See as from page 186 in the Annual Report of Rolls-Royce Holdings plc [https://www.rolls-royce.com/~/\\_media/Files/R/Rolls-Royce/documents/annual-report/2018/2018-full-annual-report.pdf](https://www.rolls-royce.com/~/_media/Files/R/Rolls-Royce/documents/annual-report/2018/2018-full-annual-report.pdf)

<sup>35</sup> See pages 34 to 36 in <https://www.accountancyeurope.eu/wp-content/uploads/170609-Standard-setting-21st-century-June-2017.pdf>

<sup>36</sup> The standard can be obtained in English from the IDW on simple demand



### *Italian good practice*

We also refer to the concept of the Collegio Sindacale<sup>37</sup> in Italy. It could be compared to the audit committee in other European countries.

The Collegio Sindacale supervises the activity of directors. It also checks that the management and administration of the company are executed in compliance with law and the deeds of incorporation. The Collegio Sindacale may at any point start an investigation and acquire relevant documents from the directors. The Collegio Sindacale is composed of three to five standing members and two supplementary members. The members of the Collegio Sindacale must be registered auditors. Shareholders can address concerns about relevant irregularities in management's behaviour to the Collegio Sindacale. The Collegio Sindacale is obliged to report their findings internally to the General Assembly. Their reports are not public.

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## Question 32

*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?*

As stipulated before, virtually all continental European countries use ISAs. ISA 200 'Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing' stipulates in paragraphs 16 and 17 that the auditor exercises professional judgement in planning and performing the audit and obtains sufficient appropriate evidence to reduce audit risk to an acceptably low level. In the Definitions, it is clarified that audit evidence includes information contained in the accounting records as well as other information. The Requirements in paragraph 16 are also further detailed in the Application Material, specifically in A28 in relation to accounting records.

We have not found evidence that this approach would have caused any issues.

The German principles of proper bookkeeping (GoB) and IDW Accounting Principles on Proper Accounting When Using Information Technology (IDW AcP FAIT 1) codify detailed requirements for the adequacy of accounting records. We are not aware of a UK equivalent.

## **CHAPTER 7: THE COMMUNICATION OF AUDIT FINDINGS**

### *Other key points*

Users of the audit product find it hard to gauge quality. Therefore, auditor communication is often taken as a proxy for audit quality and therefore, extended auditor reporting is seen by users as a step forward.

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## Question 33

*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?*

The role of the auditor at the annual general meeting (AGM) of public interest entities and large privately held entities could be reconsidered.<sup>38</sup> Some favour further dialogue between auditors and shareholders at AGMs to demonstrate the value and relevance of the audit. They propose to mostly focus on explaining the audit report and its KAMs. Other auditors consider such dialogue impossible because of national confidentiality and professional secrecy rules, which are more restrictive in some European countries than in the UK.

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<sup>37</sup> See <https://www.borsaitaliana.it/notizie/sotto-la-lente/collegio-sindacale.htm>

<sup>38</sup> See page 3 of [https://www.accountancyeurope.eu/wp-content/uploads/BP\\_110630 - Auditing - Developing the Role of the Auditor and Auditors Communication.pdf](https://www.accountancyeurope.eu/wp-content/uploads/BP_110630_-_Auditing_-_Developing_the_Role_of_the_Auditor_and_Auditors_Communication.pdf)

We would like to share the following good practice related to more open dialogue between the auditor and the users of their reports in AGMs:

### ***Dutch good practice***

In the Netherlands, the auditor can provide information (actively or upon request) on the following topics in the AGM meeting<sup>39</sup>:

- an explanation of the scope of the audit of the financial statements;
- an explanation of the way in which the group audit is organized;
- an explanation of the materiality determined;
- an explanation of the key audit matters and their choice;
- an explanation of the process of coordination and communication with the supervisory board regarding responsibility, scope of the audit, specific findings (internal management and significant aspects of financial reporting) and independence.

Substantive questions about the financial statements must be answered by the management and/or supervisory board of the company.

The auditor limits himself to answering questions about his audit procedures to substantiate his auditor's report on the financial statements. Given the (social) role of the auditor, he can also be questioned about his work on the management report, the report of the supervisory board, other information and, if applicable, about the CSR report.

When answering questions, the auditor takes into account the relevant provisions regarding the provision of price-sensitive information. The auditor also ensures that his answers to questions are correctly and completely included in the minutes of the AGM. The auditor does not respond to questions outside the annual meeting. The confidentiality obligation is fully applicable.

### ***French good practice***

In France, the statutory auditor is mandatorily invited to the AGM (and any other general meetings), but the statutory auditor is not obliged to attend<sup>40</sup>. If the statutory auditor attends, it is common practice for the statutory auditor to present the:

- Audit report on consolidated financial statements;
- Audit report on statutory financial statements;
- Report on “conventions réglementées” (related parties under French law);
- Other reports concerning the issuance of new equity instruments without preferential right of subscription

Due to the length of such reports, it is common practice to summarize them, sometimes using slides. During this presentation, the auditors present the KAMs, the opinion and the emphasis of matters. For the report on “conventions réglementées”, the auditors present a summary of the “convention”.

Statutory auditors may answer questions raised by shareholders, but within the limits of confidentiality rules applicable to statutory auditors. The auditors are not allowed to answer any other specific questions from the shareholders and can only comment on the reports they issued.

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<sup>39</sup> See pages 10 and 11 in <https://www.nba.nl/globalassets/wet--en-regelgeving/nba-handreikingen/hr-1118-accountant-in-de-ava-versie-180212.pdf>

<sup>40</sup> See section 11.32 in <http://www.bba-cpc.fr/2017/NI.I-RapportsSurLesComptes11-2017.pdf> (in French)

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## Question 34

*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?*

As far as additional communication of audit findings, the potential additional role of the audit committee should be further explored. Based on Article 39 of the Statutory Audit Directive 2014/56/EU<sup>41</sup>, the audit committee has a number of important roles related to the financial reporting, internal controls, risks management and auditing of the company. The audit committee reports to the (supervisory) board of the company but not publicly. Based on Article 11 of Regulation 537/2014 on 'Statutory Audit of Public Interest Entities'<sup>42</sup>, statutory auditors provide the audit committee with an extensive additional report on a wide range of matters related to the results of their audit including on the judgements they made related to going concern assumptions, deficiencies in internal controls, the control system, the accounting system, non-compliance with laws and regulations, valuation methods, etc.

As all this information comes together within the audit committee, there is a potential additional role for it to further communicate on its supervision of the auditors, either in writing or orally at the AGM. This suggestion should be further explored as well.

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## Question 35

*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?*

Updating KAMs featured in the previous audit report could be envisioned.

## CHAPTER 8: FRAUD

### *Other key points*

The auditor's role in fraud detection is the area where the knowledge gap (gap between what the public thinks auditors do and what auditors actually do) and evolution gap (gap between what auditors are supposed to do and what the public wants auditors to do) are the most pronounced<sup>43</sup>.

The opportunity for fraud within companies (and beyond) has expanded with the increase in complexity of business, globalisation of transactions, use of intangibles assets, etc.

There are many challenges in preventing and detecting fraud, especially in case of collusion, weaknesses in or override of internal controls, dictatorial management etc. The 2018 Global Study on Occupational Fraud and Abuse of the Association of Certified Fraud Examiners (ACFE)<sup>44</sup> suggests that whistleblowing is the most common means of detection of fraud at 40%, more than internal audit (15%) and management review (13%) combined. External audit, according to this study, uncovers just 4% of fraud cases.

In November 2018, we held a conference on governance and fighting fraud and financial crime in the digital era<sup>45</sup>. Overall conclusions of the discussions called for a coordinated approach and commitment of all key players to achieve tangible results, detailed as follows:

- Coordination: all parties in the financial reporting chain should work together to implement and enforce corporate governance codes and report on incidents and sanctions.
- Harness the use of technology: use of data analytics, data mining processes, machine-learning and artificial intelligence can impact information flows and help expose problems. Numerous affordable

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<sup>41</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02006L0043-20140616&from=EN>

<sup>42</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=en>

<sup>43</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/180112\\_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf](https://www.accountancyeurope.eu/wp-content/uploads/180112_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf)

<sup>44</sup> See page 17 <https://s3-us-west-2.amazonaws.com/acfepublic/2018-report-to-the-nations.pdf>

<sup>45</sup> See for summary <https://www.accountancyeurope.eu/wp-content/uploads/190111-Governance-and-fighting-fraud-and-financial-crime-in-the-digital-era-summary-final.pdf>

technologies are available to identify fraud risks and investigate fraud – preventive and forensic tools – and these should be used to full effect.

- Collaboration: successfully tackling financial crime and fraud depends upon a joint effort by all relevant parties including business leaders, audit committees, accountants and auditors, the financial sector, standard setters, supervisors, regulators who should collaborate to share information, understand the meaning of data and then take action (together).

As indicated already, the use of technology is well embedded in forensic procedures, often brought in in case of suspicion of fraud or other issues. This comes at a cost, often a significant one.

The use of technology within an audit of financial statements has started and is in a transitional phase but offers new opportunities. For instance, in some countries, forensic experts already contribute to the audit planning and risk assessment to focus particularly on fraud risks.

Most expect that the extended use of technology, enabling auditors to look at the entire population of transactions rather than just samples of it, can help to improve fraud risk assessment. There is an expectation that this will eventually contribute to providing better audit and assurance services around the detection of fraud in companies. This can also help to be more explicit on what has already been done on fraud and non-compliance with laws and regulations (NOCLAR) (see our response to Question 38 for more details). Accordingly, the accountancy profession is committed to developing data analytics tools and new skillsets needed for this area.<sup>46</sup>

However, there is always a completeness risk that technology is used on a population which may not contain 100% of the transactions. Therefore, the importance of well-functioning risk management and internal control systems and processes cannot be stressed enough in relation to the prevention and detecting of fraud within a company. Reference is made to our responses to Chapter 4.

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## Question 36

*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?*

Users seem to expect auditors to deter, detect and communicate on all significant fraud committed within an organisation. Users have difficulty to understand that auditors do not actively look for fraud, that they 'only' pursue the detection of potential fraud further if suspicion has arisen during the course of the audit and that such actions would be 'limited' to financial reporting fraud only.

However, currently auditors cannot directly prevent financial crime including fraud from happening, but they can tailor their work to increase the chance of detecting it, but this remains very challenging. Currently, ISAs do not go beyond compliance with laws and regulations that are not related to financial statements.

### ***Estonian good practice***

The Estonian Auditors' Association has made several proposals to extend the audit requirements to branches operating in Estonia. The need for such a move was clearly highlighted by high-scale money laundering scandals in 2018, when branches of foreign banks were found to have laundered money, but they were not audited locally as deemed too insignificant from the group audit perspective and scoped out (by the group auditor). The proposals have not been approved so far.

Since 2015, Estonian auditors have to report on how (some of) their state-owned audit clients adhere to the national corruption legislation, especially with regard to related parties. The reporting is not public, recipients are either the National Audit Office or the management of such state-owned companies (who then have to pass on such reporting).

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<sup>46</sup> See page 12 [https://www.accountancyeurope.eu/wp-content/uploads/180112\\_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf](https://www.accountancyeurope.eu/wp-content/uploads/180112_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf)

### *European good practice*

European Union law does currently not require the auditor to specifically look for money laundering and terrorist financing, but to report suspicion of such activities. Ultimately, it is up to a court to determine whether a criminal act has been committed<sup>47</sup>. Indeed, as part of the fight against financial crime, auditors fall under the application of the European Union 'Anti Money Laundering Directives 2015/849'<sup>48</sup> (4th AMLD) and 2018/843<sup>49</sup> (5th AMLD) (yet to be implemented).

The 4th AMLD requires companies to store adequate, accurate, and current information on their own beneficial ownership in a central register located outside the company. The 5th AMLD will require that beneficial owners provide companies with the information they need which companies will need to provide to their auditors.

The 4th AMLD requires auditors to apply enhanced customer due diligence measures, i.e. extra checks and monitoring of financial transactions in order to prevent, detect and disrupt suspicious transactions when the customer risk is considered greater.

Customer Due Diligence (CDD):

- Auditors need to identify their customer and verify their identity based on documents, data or information obtained from a reliable and independent source.
- Auditors must apply CDD measures to existing customers in two cases: (i) at 'appropriate times' on a risk-sensitive basis or (ii) when the relevant circumstances of a customer change.

Auditors must also apply additional due diligence measures when dealing with politically exposed persons (PEPs).

Under the 4th AMLD, auditors have to report suspicions of money laundering internally or to the national Financial Intelligence Unit and must be protected from threats, retaliatory or hostile action, and adverse or discriminatory employment actions. The 5th AMLD extends this protection by introducing a right of complaint and effective remedy for accountants and auditors that are exposed to retaliatory action for reporting their suspicions.

The main areas where the need for further improvement in relation to the auditor's involvement with AML was identified:

- The risk of failure to identify AML risks is high while conducting AML checks in financial audits. In most EU Member States the law does not require the auditor to specifically look for money laundering and terrorist financing, but to report suspicion of such activities on the sample examined.
- The recognition that the risk increases while dealing with non-European customers coming from jurisdictions with different AML requirements than the European countries.
- The risk that auditors classify their activities as low risk, even though they offer moderate to high risk services.
- The need to improve the Know Your Client (KYC) policies within audit firms, which vary considerably.
- After the acceptance of companies as clients, staying alert as auditors on unusual transactions, suspicious behaviour and changes in the client's business model.
- Smaller audit firms may become 'too familiar' with their clients and allow personal relationships to compromise the necessary scepticism to 'false positive' disclosures.

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### Question 37

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

Based on the ISAs, the auditor is concerned with fraud that causes the financial statements to be materially misstated. The term fraud and the associated auditor's responsibilities in the ISAs only refer to fraud as a result of fraudulent financial reporting or misappropriation of assets.

However, auditing standards require auditors to plan and perform an audit with professional scepticism, i.e. a questioning mind and being alert to conditions which may indicate that circumstances may exist that cause the

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<sup>47</sup> See page 2 <https://www.accountancyeurope.eu/wp-content/uploads/Communication-Auditors-role-in-the-fight-against-fraud-and-corruption-3.pdf>

<sup>48</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L0849&from=EN>

<sup>49</sup> See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>

financial statements to be materially misstated. In addition, the auditor will obtain an understanding of the risk management and internal control systems to assess the risks of material misstatements, also if due to fraud.

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## Question 38

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

As referred to before, inspiration could be found in the International Ethics Standards Board for Accountants (IESBA) pronouncement of July 2016 on Responding to Non-Compliance with Laws and Regulations<sup>50</sup> (commonly referred to as NOCLAR). It sets out the professional accountant (including auditor)’s responsibilities when encountering non-compliance or suspected non-compliance with laws and regulations. It guides the professional accountant in assessing the implications of the matter and the possible courses of action when responding to it. It indicates the responsibilities of both the company’s management and those charged with governance as well as the auditors. It guides auditors in obtaining an understanding of the matter, addressing it, determining whether further action is needed and documenting the work done. Related to the latter two, the auditor has to exercise professional judgement and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available at the time, would be likely to conclude that the auditor has acted appropriately in the public interest.

Whether the use of a ‘reasonable person’ test would be helpful is untested and thus a whole other matter.

## CHAPTER 9: AUDITOR LIABILITY

### *Other key points*

The Bannerman paragraph is a UK phenomenon that does not exist in other European countries. In other countries with a regime of unlimited auditor’s liability, auditors often have a broader duty of care beyond the company and its shareholders and are accountable to other stakeholders including financial institutions, creditors, employees, liquidators. We refer to our overview of the liability regimes across 29 European countries in our response to Questions 41 and 42.

Many auditors do not see unlimited liability as the main impediment against future innovation in audit. There is need for a broader discussion on the risk and reward model of the audit profession, which we have started already internally. Whatever the liability regime, regulators still have the ability to sanction auditors for poor quality audits.

However, unlimited liability is seen as an important factor within audit markets. It is often a barrier to entry for new, smaller competitors.

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## Question 40

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

Expanding the scope of the audit and assurance and the responsibilities and accountability of auditors necessitates addressing its impact on the wider duty of care and liability of auditors.

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## Question 41

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

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<sup>50</sup> See <https://www.ifac.org/system/files/publications/files/IESBA-Responding-to-NOCLAR-Pronouncement.pdf>

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## Question 42

*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?*

We do not directly respond to the question, but we have not found evidence that the differences in auditor liability regimes across Europe result in significant difference in audit quality. We believe that liability rules should be adapted to the subject matters assured which is expected to widen the scope of assurance and competition in the market.

Overview of the auditor liability regimes across 29 European countries<sup>51</sup>: 12 European countries operate a legal cap of the statutory auditor's liability, seven have unlimited auditor's liability, six have a system of proportionate liability and four others have a legal possibility for contractual limitation of the statutory auditor's liability, the latter often not commonly used in practice.

### **Auditor liability regimes in Europe (European Union except Croatia, plus Norway and Switzerland)**

In European countries, the following liability regimes for statutory audit are currently in place:

- **Unlimited liability** (Czech Republic, Finland, Ireland, Latvia, Norway, Sweden, Switzerland)
- **Legal cap** (Austria, Belgium, Bulgaria, Cyprus, Estonia, Germany, Greece, Poland, Portugal, Romania, Slovakia, Slovenia)

In several countries, the applicable cap is calculated as a multiple of audit fees, with the cap often being higher in case of public interest entity (PIE) audits. In other countries, the cap depends solely upon the size of the audited entity.

Due to different rules applicable across Europe, the maximum amount of the cap varies from country to country.

For example, in Poland, the cap for PIE audits is 20 times the audit fees with the maximum amount set to EUR 12 million while for audits of non-PIEs the cap is 3 times the audit fees with the maximum amount being EUR 3 million.

Another example is Germany, where a legal cap of EUR 1 million for audits of non-listed companies applies in case of negligence when a statutory audit is required by law. For listed companies the legal cap is EUR 4 million. There is no legal cap for audits if no statutory audit is required by law (but a cap can be agreed contractually).

Note that the caps usually do not apply in cases of wilful misconduct or gross negligence by the auditor.

- **Proportionate** (Denmark, France, Hungary<sup>52</sup>, Italy<sup>53</sup>, Malta, Spain)

Proportionate liability means that for the statutory audit of financial statements, the auditor's liability is determined proportionately to the damages caused by the fault of the auditor.

- **Contractual** (Lithuania, Luxembourg, Netherlands<sup>54</sup>, UK)

Contractual limitation of statutory auditor's liability is legally possible but is not commonly used in practice in these countries.

### **Liability in countries with joint audit: country example**

In France, the only European market where joint audits are mandatory in certain cases (audit of consolidated financial statements), joint auditors are jointly and severally liable. In light of the specific facts and circumstances

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<sup>51</sup> Accountancy Europe has informally gathered this information from different sources without any further verification. Please note that it may already be out of date and subject to change.

<sup>52</sup> Final decision on this was still pending according to the latest available information from March 2017.

<sup>53</sup> In addition, joint liability with directors applies.

<sup>54</sup> Principle of proportionality applied in practice although it is not stated in the national legislation. See also the Dutch country example on boarder duty of care to others then shareholders.

of the case, the civil or the disciplinary court can decide a different allocation of damages and sanctions between the joint auditors.

#### **Limitation of liability for services other than statutory audit: country examples**

Denmark: While proportionate liability applies for statutory audits, for other engagements, the auditor may reduce the financial obligations by contract and introduce a liability cap.

Sweden: Although liability for the statutory audit cannot be limited, caps for attest and non-attest work can be stipulated by contract.

#### **Broader duty of care to others than shareholders/investors: country example**

Netherlands: auditors are accountable to other stakeholders including financial institutions, creditors, employees, liquidators etc. Any contractual limitation of the auditor's liability will only be effective between the auditor and his principal (i.e. the audited entity), not extent to any third parties including shareholders.

## **CHAPTER 10: OTHER ISSUES**

### *Technology*

#### *Other key points*

The use of technology in audit is a fact, especially in larger audits. Those audit firms are in the middle of a digital transformation and what is done today is very likely to change tomorrow. Larger audit firms are investing heavily to meet expectations in this area, but this is a more significant challenge for smaller firms trying to catch-up with the use of off-the shelf packages. Digitalisation of audit profession is important as it also has the potential to increase the level of relevance and value of an audit.

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### **Question 45**

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

At the Digital Day of Accountancy Europe on 19 June 2018, we had a session on audit and innovation<sup>55</sup>. Our panel commented that audit firms make more use of companies' data to enhance audit quality and that the possibilities of using data analytics to increase audit quality are endless. They highlighted that the real challenge is to identify the right capabilities and the useful outcome of audit procedures using data analytics. They also considered that data analytics is a game changer in many areas like internal controls, predictive data analytics, corroboration with enterprise resource programs (ERPs), fraud detection and anti-fraud procedures, areas of judgement and machine learning.

As an aside, there are also challenges, for instance in ensuring the integrity of the data and in extracting the data from some older legacy systems. Therefore, companies also need to invest to make this happen, which many already do. However, smaller companies, and in turn also their auditors, might struggle more with this.

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### **Question 46**

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

In February 2018, Jyoti Banerjee wrote a paper on 'The changing flows of corporate performance information' for Fronesis<sup>56</sup>. It considers the flows of corporate information which are complex. 20th century corporate reporting

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<sup>55</sup> See <https://www.accountancyeurope.eu/audit/digital-day-2018-break-out-session-summary-2/>

<sup>56</sup> See <http://fronesis.com/the-changing-flows-of-corporate-performance-information/>



practice can be likened to a 'tap' with flows of information which are periodic, restricted to when the tap is turned on and uni-directional, as the reporting company chooses what to say and when to say it.

In contrast, 21st century corporate information flows are more like a 'lake' – all participants in the system have the opportunity to use the water (information) in the 'lake' in multiple ways, carrying out numerous processes, including creating, distributing and consuming corporate performance information. Of course, the 'tap' continues to carry out its function in the age of the 'lake', but it is only one source of water feeding the 'lake'.

These digital trends and the movement of the system from "tap" to "lake" is not a future event, it is already taking place around us. It is primarily enabled by technologies that are commonplace in the information revolution.

This idea demonstrates that the audit profession and its stakeholders will have to reflect on how assurance could be provided on such changed reporting, combining assurance and IT skills.

A next step might be adding a level of integrity to algorithms of online platforms like booking.com alerting when viewing a hotel room that there is only one left on the indicated date. And one day, there might be real time reporting in public and real time or continuous audit on it.

## **CHAPTER 10: OTHER ISSUES**

### *Proportionality*

#### *Other key points*

Based on the principles of good regulation, far-reaching changes to the current purpose and scope of the audit should be based on the outcome of a cost/benefit analysis or impact assessment. This is important as we hear time and time again from users and other stakeholders that they continue to see value in the current audit of financial statements.

The value and relevance of audit is questioned more when considering the audit of small and less complex entities<sup>57</sup> where the requirements of the current one-size-fits-all auditing standards are seen as disproportionate to audit such entities. A call for simplification is becoming louder<sup>58</sup>. In April 2019, the IAASB has issued a Discussion Paper to respond to this challenge<sup>59</sup>.

## **CHAPTER 10: OTHER ISSUES**

### *Culture*

#### *Other key points*

Understanding culture at a prospective client could form part of the audit engagement acceptance procedures. As part of the fight against financial crime, auditors already fall under the application of the European Union Anti Money Laundering Directives. Auditors are required to apply enhanced customer due diligence measures, i.e. extra checks and monitoring of financial transactions in order to prevent, detect and disrupt suspicious transactions when the customer risk is considered greater.

This also relates to understanding the control environment at the company which the auditor will consider as part of the work on risk management and internal control systems and processes.

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<sup>57</sup> See <https://www.accountancyeurope.eu/wp-content/uploads/180209-Rediscovering-the-value-of-SME-audit-Recent-developments-in-Sweden-and-Denmark-1.pdf>

<sup>58</sup> See <https://www.accountancyeurope.eu/publications/simplifying-auditing-standards-small-non-complex-entities/>

<sup>59</sup> See <https://www.ifac.org/system/files/publications/files/IAASB-Discussion-Paper-Audits-of-Less-Complex-Entities.pdf>

A similar discussion related to culture is ongoing relating to audit firms, instigated by the publication of the IAASB Exposure Draft for International Standard on Quality Management (ISQM) 1<sup>60</sup>.

In this respect, we would like to bring our work on the attractiveness of the audit profession to your attention, which includes a number of factors influencing the attractiveness of the audit profession<sup>61</sup>. Qualification as an auditor, regulation, compliance mindset, technology and work-life balance were the most important factors named.

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<sup>60</sup> See <https://www.ifac.org/system/files/publications/files/IAASB-Proposed-ISQM-1-Explanatory-Memorandum.pdf>

<sup>61</sup> See [https://www.accountancyeurope.eu/wp-content/uploads/Keeping-the-Audit-Profession-Attractive\\_18.07.2017.pdf](https://www.accountancyeurope.eu/wp-content/uploads/Keeping-the-Audit-Profession-Attractive_18.07.2017.pdf)