Subject: Accountancy Europe's comments to the US CAQ's publication: Auditing in the Age of Generative AI

Dear Sir or Madam,

Accountancy Europe is pleased to provide you with its comments on the Center for Audit Quality (CAQ) publication _Auditing in the Age of Generative AI_ – _April 2024_ (the CAQ publication).

There are many questions and concerns about how evolving technologies impact businesses, society and professions. We already observe that technology has been transforming financial reporting and auditing. Generative AI (genAI), in particular, may have a far-reaching impact on the way audit and assurance engagements are performed, the talent agenda as well as on firms' overall quality management.

Accountancy Europe's Task Force on Audit and Technology works on the technological transformation of auditing, including the challenges and opportunities brought by this evolution. In this context, we welcome that the CAQ has also identified the need to explore new risks arising from the use of genAI in financial reporting, including internal control, and related implications for the audit.

We recognise that the scope of the paper was deliberately limited to genAI. Our comments, however, include considerations related to the three other subsets presented in the CAQ publication: artificial intelligence, machine learning and deep learning.

Our letter is structured as below:

- the first section includes specific comments on the perspectives set out in the CAQ publication
- the second section describes the European Union (EU) context
- the third and the last section touches upon a few topics that we believe the CAQ and Accountancy Europe could further explore in collaboration

AI-based models and systems can be utilized in company reporting or audit engagements. Different considerations apply to these two use cases. Throughout this document, we aim to clarify when a specific reference pertains to use of AI by auditors.

www.accountancyeurope.eu
Avenue d'Auderghem 22-28
1040 Brussels

EU Transparency Register
4713568401-18

BECAUSE
PEOPLE
COUNT.

SPECIFIC COMMENTS

OVERVIEW OF GENAI: WHAT AUDITORS NEED TO KNOW

This chapter provides a comprehensive and concise overview of GenAI. The boxes in yellow (i.e. Considerations for Auditors), in particular, include useful perspectives and it would be even more helpful if these can be linked to potential risks of material misstatement that auditors could encounter during financial statements audit. This could help the profession better understand the impact on their daily jobs.

The final part that contrasts AI with automation is also important as some stakeholders assume that these two are the same. It is quite essential to recognise the differences. In general, automation is linear and replicates a standardised process in high volumes. Automation has a design and usually a code that can be reviewed. Accordingly, the same output will be generated every time based on the same inputs. GenAI, however, mimics human behaviour using probabilistic processes. Even with the same inputs, depending on the scenario and prompts used, it will most likely generate different outcomes each time. This part of the CAQ publication can be expanded further to highlight the implications of these differences for the auditor, especially with regards to documentation. An interesting reflection could also be to investigate under which circumstances auditors could rely on the outcome of genAI without human intervention.

THE REGULATORY ENVIRONMENT

We agree with the considerations noted in this chapter of the paper and expect that there will be more regulation around AI governance in the future, introducing requirements and enforcement measures for non-compliance. Auditors should understand and consider the regulatory framework at their clients in identifying and responding to the risk of non-compliance with laws and regulations by the audited entity.

Standard setters and audit oversight bodies will also need to update their tools and methodologies to ensure that their supervisory approach is compatible with evolving technologies and their expectations from auditors are clear in cases where these technologies are employed. As an example, the Public Company Accounting Oversight Board (PCAOB-US) recently revised two of its auditing standards addressing audit procedures that involve technology-assisted analysis of information in electronic form.

Please also see our comments below under EU context.

CONSIDERATIONS WHEN AUDITING COMPANIES THAT ARE DEPLOYING GENAI

This chapter provides a comprehensive view of potential risk areas along with key questions for auditor's consideration.

In principle, auditors need to understand when and where the audited entity uses GenAI and what kind of controls are in place to make sure that the outcomes are accurate for the processes that are relevant for the audit. This is key for the auditor when assessing how inherent risk factors may affect susceptibility of assertions to misstatement.

In addition to those covered in the CAQ publication, there may be other risks related to the data used to train the AI models. The sources of such data and their reliability (i.e. completeness and accuracy) may introduce additional risks and bias into the AI models if not carefully handled and governed. In addition, there may be confidentiality and copyright concerns about the company's right to use the data for the intended purposes.

In principle, auditors cannot rely on the procedures without being able to challenge the technology and processes used. As IT controls support the system of internal control and involve judgement, and the auditor may not be able to reperform those procedures, the design of the model becomes a key consideration. Even if the entity confirms that they are applied correctly, the evaluation of those models and operating effectiveness of relevant controls, might be challenging. Human intervention and testing of the result seems to be the most practical approach for the auditor. However, these may also be automated with the help of genAI technologies in the future.

EXAMPLE USE CASES

The CAQ paper includes 2 examples of how a company may be using genAI technologies in drafting financial statement disclosures and drafting code for reports. The perspectives below relate to use cases in audit and assurance services.

Some audit firms have AI tools in place for their staff to use when preparing administrative documents such as emails, memos, audit-related inquiries, and presentations. There are also AI-enabled tools to assist auditors in researching technical consultations for contentious accounting and legal matters.

In addition, AI-based technologies are already used in audit engagements for risk identification, anomaly detection, and gathering value-added insights from vast amounts of data available. Audit firms are investing in genAI technologies with a view to develop more proactive, continuous, and predictive procedures to improve the quality and efficiency of audit engagements.

Recent PCAOB-US research shows that auditors primarily use technology-assisted analysis to identify and assess risks of material misstatement. This enables the auditor to identify new risks or to refine the risks already identified and assessed. In this regard, it serves mainly as a complementary tool.

GenAI has the potential to open other use cases for audit and assurance services. The adoption of AI continues to evolve as firms are in the process of investing in and operationalising new AI technologies. In collaboration with their business partners, firms are looking for ways to accelerate core processes of audit and assurance engagements while improving the reliability of the results provided by AI-models and complying with ethical requirements, including those related to independence.

We would like to cooperate with the CAQ to share further use cases with the wider audit profession. Examples could be:

- Automated tie out of financial statements
- Intelligent audit platforms such as Datasnipper
- ESG benchmarking solution(s) based on AI-models

ADDITIONAL AUDIT CONSIDERATIONS

We agree that auditors need additional and customised training related to genAI technologies. The scope and the extent of this training should be determined diligently and updated as necessary.

At individual-level, core skills and knowledge that an auditor needs to have should be determined. There is also a role to play for professional accountancy organisations and audit oversight bodies with regards to how this will be embedded into initial certification and continuing professional education requirements for auditors.

At team-level, an engagement leader should ensure that members of the engagement team collectively have the appropriate competence and capabilities, including sufficient time, to perform the engagement in accordance with professional standards and with due care. This may necessitate

involving IT and AI experts where specialised skills are needed for effective understanding, assessment of and responses to risks linked to AI systems used in financial reporting.

EU CONTEXT: A EUROPE FIT FOR THE DIGITAL AGE

The EU authorities have been taking significant steps to strengthen EU's digital sovereignty and to set its own standards with a focus on data and technology infrastructure.

In this regard, in 2022, a digital services package was adopted to regulate the EU digital space and to protect online users:

- the Digital Services Act (DSA) establishes a set of responsibilities and a transparency framework for providers of online intermediary services
- the Digital Markets Act (DMA) aims to recalibrate competition in the EU digital economy, while boosting fair competition and innovation

The same year, the EU co-legislators formally adopted the Digital Operational Resilience Act (DORA) which contains a broad range of measures aimed at improving the robustness of financial-sector information and communication technology (ICT) infrastructures, covering both in-house systems and services outsourced to third-party providers.

In some cases, such as DSA, EU legislation requires an independent assurance (i.e. audit) related to compliance with the requirements which may include reporting by companies in scope.

EU AI ACT

Another significant legislation, the EU AI Act, entered into force on 1 August 2024 and will be fully applicable in 2 years. The Act introduced harmonised rules for the development and deployment of AI systems in the EU market. It follows a risk-based approach that prohibits certain particularly harmful AI practices. In addition, specific restrictions and safeguards are introduced for uses of remote biometric identification systems in law enforcement. The "high-risk" AI systems that pose significant risks to health and safety or fundamental human rights have to comply with a set of requirements and to follow conformity assessment procedures before those systems can be placed on the market or put into service. For general-purpose AI systems, only minimum transparency obligations are required, for example when chatbots are used.

In the EU context, this legislation is fundamental, and auditors should be aware of the requirements introduced. Entities within its scope should be able to provide the inventory of AI systems and tools in use as well as documentation that a proper governance is in place. This information will support auditors in their risk assessment.

DIGITAL CORPORATE REPORTING IN EU

Issuers in the EU are required to prepare their consolidated financial statements in a machine-readable (XBRL) format if these statements are prepared in accordance with the International Financial Reporting Standards (IFRS). Auditors opine on whether the digitised consolidated financial statements are prepared in accordance with the taxonomy and regulatory requirements.

Companies within the scope of the Corporate Sustainability Reporting Directive (CSRD) will need to mark-up their sustainability statements using XBRL technology once relevant digital taxonomy is developed. Sustainability assurance providers will express an opinion on compliance with this requirement.

By July 2027, the European Single Access Point (ESAP) will be set up as an EU-wide mechanism providing digital and centralised access to financial and sustainability information disclosed by companies in the EU. Machine-readable and audited financial and sustainability statements that are easily accessible via ESAP will be an essential source of data that can be used to train AI models related to corporate reporting. Likewise, audit firms and sustainability assurance providers may benefit from such data when designing AI-based audit and assurance procedures as well as developing their training programmes.

TOPICS FOR FURTHER EXPLORATION

DYNAMIC (AND DISRUPTIVE) NATURE OF GENAI

Tools and technologies using GenAI is evolving very rapidly. There is a need to explore how the dynamic, and sometimes disruptive, nature of this evolution can be addressed by the auditor throughout the engagement. This could include implications for the auditor's risk assessment, planned extent and timing of audit procedures as well as reliance on internal control.

Similarly, a company's policies and procedures dealing with AI should be updated depending on the developments in its organisation, industry and the regulatory environment. Their risk management and internal control systems should be flexible enough to stay relevant under these evolving circumstances.

(PERCEIVED) REGULATORY UNCERTAINTY

In general, there is a lag between the emergence of new technologies and the establishment of relevant regulatory frameworks. This creates a certain level of uncertainty with regards to the use of such tools, and about whether their use may or may not be acceptable by supervisory authorities.

Likewise, revision of professional standards take time leading to a risk of misalignment between the requirements of these standards and how audit engagements are conducted in practice. Compliance concerns may result in auditors being reluctant to use technology-assisted techniques.

It is therefore essential that supervisory approaches and professional standards embrace technology-driven innovation and do not include any real or perceived barriers to the use of emerging technologies.

SPECIFIC INTERESTS AND NEEDS OF SMPS

AI-based tools can assist small and medium size practitioners (SMPs) to enhance their work efficiency, enabling them to deal with the talent shortage. However, deploying such tools may demand significant investments and may not always yield the expected results within the planned timeframe. Considering the potential cost of compliance with regulatory requirements, this can constitute another barrier for SMPs. Since having a diverse and resilient audit market with enough audit firms active in it is crucial for the public interest, the AI ecosystem should give particular attention to the needs of SMPs.

PROFESSIONAL DEVELOPMENT OF JUNIOR AUDITORS

A significant risk brought by GenAI, which is often overlooked, is its impact on junior staff members' learning and understanding. GenAI can perform repetitive and low-level judgement tasks allowing auditors to spend more time on critical matters. It may also reduce the need to travel and visit audited entity sites for performing audit procedures such as inquiries and inventory testing. However, these tasks and exposure to audited entity's staff can be particularly valuable for junior auditors' professional development. There is a need to reevaluate the training of new talent while more and more tasks are being automated.
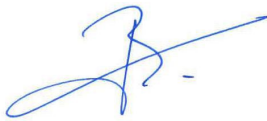
SUSTAINABLE OR RESPONSIBLE AI

GenAI technologies consume a significant amount of energy and lead to large greenhouse gas (GHG) emissions while training their models and operating systems based on these models. Accordingly, companies need to consider the environmental impacts of AI solutions throughout their lifecycle before making decisions and choices about these solutions. There may also be social impacts that need to be considered, such as the risk of inherent bias in algorithms or training data that may lead to favouritism and discrimination.

We hope that you find the perspectives presented in this letter useful and are looking forward to collaborating with the US CAQ with a view to play our role in shaping the future of the auditing profession.

For further information on this Accountancy Europe letter, please contact Hilde Blomme hilde@accountancyeurope.eu or Harun Saki harun@accountancyeurope.eu.

Sincerely,

Olivier Boutellis-Taft

Chief Executive

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 49 professional organisations from 35 countries that represent close to **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).