



17th July 2020

By email to aat@frc.org.uk FAO Jason Bradley

Dear Jason

**FRC Discussion - Technological resources: using technology to enhance audit quality
March 2020**

1. Key points

- 1.1. We are grateful for and welcome the ability to respond to the FRC's discussion on using technology to enhance audit quality. We set out in this section our key points.
- 1.2. We believe that the use of technology in audits will provide both increased efficiency and enhanced quality. This is a result of larger financial data populations being covered, boring repetitive audit tasks (eg checking the adding up of ledger entries; checking completeness; confirming period cut offs) being automated, and audit time being freed up to get answers to more searching and challenging questions of an audited entity. There is also the possibility that audit technology is being used to generate appropriate analysis of data for audit follow up and resolution of exceptions and anomalies. These technical advancements also need to be assessed and verified, audited if you will, in order to be used in audits. In the same way as computer audits have to assess and attest a company's computer controls and data, the auditor will have to provide the same assurance on their audit technology.
- 1.3. However, we are not yet convinced that AI and other advanced tools are widely used, mainly because it is still early days in the world of AI. Most AI and advanced tools are still computer automation in the sense of being binary and the result of more sophisticated decision trees in programs.
- 1.4. Even with the generally used audit technology, there is a need for audited entities to improve their accounting record systems and financial data, including through adopting appropriate data standards.
- 1.5. It is not obvious that the challenger firms are currently at any disadvantage.
- 1.6. Most, if not all, audit documentation and ethical concerns may be dealt with using existing requirements.
- 1.7. We are not aware of anything else that should be considered in this discussion and suggest that the discussion is revisited when audit technology has seen more advances and use in say three to five years' time.

2. Introduction

- 2.1. UKSA and ShareSoc represent the interests of private shareholders. In addition to our own members, there are 5 million people who own shares and have investment accounts with platforms in the UK. The Office for National Statistics estimates that individual investors own 13.5% of the UK stock market by value at the end of 2018. In addition to this there are many more who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes.
- 2.2. As representatives of the interests of private shareholders, we will not have the detailed insight that auditors have into the use of technology in audits. However, as users of audits and companies' annual reports, we do have views on the use of technology in the annual reporting process and we have tried to present these in the key points section above and in the answers to your discussion questions below.

3. Technological innovation and audit quality

3.1. Question 1: Do you agree that the increasing use of technological resources, including AI and other advanced tools, enhances the quality of audits, beyond the benefits derived from efficiency gains. If so, what are the indicators of enhanced quality?

- 3.1.1. Yes, we agree that the increasing use of technological resources enhances the quality of audits. Automation enquiry techniques will allow audits to cover larger or complete financial data populations compared to say manual substantive audit testing sampling techniques. They may also provide analysis of those populations including exceptions or material anomalies for further investigation.
- 3.1.2. It is too early to tell whether AI and other advanced tools, whatever advanced tools may mean, enhance the quality of audits. In so far as our knowledge and experience suggest, the computer automation and analysis techniques used in audit are just that even though they may be described as AI or other advanced tools. Proper AI, where machines can think for themselves without human intervention, or artificial general intelligence, is we believe some way off. If you are aware they are being used, we imagine they will be hampered by the quality of the technology of the entities being audited.
- 3.1.3. If our assessment is reasonably accurate, the audit quality indicators ("AQIs") will be those that demonstrate the completeness and accuracy of the financial data populations being audited, the number of exceptions or anomalies produced by the automatic analyses, the resolution of these exceptions or anomalies and the level of confidence in the financial data that these processes provide.

3.2. Question 2: Do you believe that challenger firms are currently at a disadvantage in the use of new technology? If so, what remedies would you suggest?

- 3.2.1. No. Following the logic of our answers to Question 1, the level of automation used in audits, that is enhancing audit quality, should be accessible to challenger firms. We understand that Grant Thornton have invested significantly in their audit automation.

- 3.2.2. However, we recognise that the larger firms will have more resources, in terms of both money and people (and therefore possibly time), to develop technological resources, especially AI and other advanced tools. However, we do not believe AI and other advanced tools are prevalent yet in audits. Therefore, challenger firms appear to be at a disadvantage in developing AI and other advanced tools. The audit regulator will need to keep a close watch on developments and any risk of one firm starting to acquire a near monopoly due to technical superiority.
- 3.2.3. Until it is obvious that challenger firms are at a technological disadvantage, there should be no need for remedies. When it is obvious, the audit regulator should look to making the advanced technology fairly available to challenger firms.

3.3. Question 3: Other than investment, what do you believe are the key challenges auditors face in the increasing utilisation of automated tools and techniques within the audit process? Again, what remedies would you suggest to overcome these challenges?

- 3.3.1. The key challenge will be whether the systems and data of audited entities are compatible with the audit technology used by the auditors.
- 3.3.2. The obvious remedy will be having appropriate data standards as intimated in paras 19 and 20 of your discussion document (see Question 9 below at 5.1).

3.4. Question 4: Does the current assurance model or the auditing standards represent an obstacle to technological innovation? If yes, then what specific standards, objectives, requirements or guidance cause practitioners particular difficulties?

- 3.4.1. We do not know enough detail about the current assurance model or the auditing standards, as not audit practitioners, to know if they represent an obstacle to technological innovation. Our perception is that they should not be as the automation in general use in audits and still being developed enhances the previously manual processes envisaged by the model and audit standards. In any case, if auditing standards have been developed on a principles basis, they should be capable of being applied to both manual and technology situations and therefore should never be an obstacle to technological innovation. This appears to be the case so far.
- 3.4.2. It is for practitioners to answer the second part of the question. Where you may find more insight into any obstacles to technological innovation as a result of this consultation, we would be happy to provide feedback on any practitioner suggested required amendments to specific standards, objectives, requirements or guidance to reduce or remove any obstacles.

3.5. Question 5: Do you believe the current level of training given to auditors – both trainees and experienced staff – is sufficient to allow them to understand and deploy the technological resources being made available?

- 3.5.1. If the technological resources available remain binary and subject to binary decision tree processes, we believe the level of training is sufficient. We understand that trainees and qualified staff are required to pass the chartered accountancy qualification, and this includes reasonably up to date training and

exams in technology and computers. Also, computer auditors, specialists in auditing auditee computers, will have the required training for both computer audits and assessing and assuring audit technology.

- 3.5.2. However, we recognise that auditors spend many years training to understand accounts and audit methods and their technological training may be superficial. This should be mitigated by computer auditors. Technology is more complex than accounting but presented in way that makes it easy to use. We must not confuse usability with simplicity. The easier a tool is to use, the greater the complexity of the underlying technology. Therefore, where technology is involved, auditors should take nothing for granted.

4. Artificial Intelligence, Machine Learning and Natural Language Processing

4.1. Question 6: What firm-wide controls do you believe are appropriate to ensure that new technology is deployed appropriately and consistently with the requirements of the auditing standards, and provides high quality assurance which the firm can assure and replicate more widely?

- 4.1.1. The appropriate firm wide controls are the same as those used in any business, whose processes and data are computerised. Firm wide controls will also need sufficient controls to ensure audits retain, keep accessible and safe technology based audit evidence.

4.2. Question 7: Are you aware of the use of new technologies in analysing and interpreting information provided by auditors – including, for example, auditor's reports? If yes, then do you foresee implications for the form and content of auditor's reports?

- 4.2.1. We are aware that new technologies could be used in analysing and interpreting information provided by auditors. However, we are not sufficiently knowledgeable of these technologies to comment on the implications for the form and content of auditor's reports.

4.3. Question 8: What do you see as being the main ethical implications arising from the greater use of technology and analytics in an audit?

- 4.3.1. The main ethical implications will be the level of confidence that auditors may have in the completeness, accuracy and integrity of their technology used in audits and how they may demonstrate this to third parties such as the regulator's reviews of their audits, audit committees and eventually the shareholders in companies they report to. This should be mitigated by clear documentation on audit files of how the technology works, on what IT controls there are to ensure confidence in its completeness, accuracy and integrity and of the results of using the technology.

5. Data Standards and Extraction issues

5.1. Question 9: Do you believe there is value in the UK having consistent data standards to support high quality audit, similar to that developed in the US?

- 5.1.1. With reference to our answer at 3.1.2 and your Question 3 at 3.3, we believe it is essential in the UK having consistent data standards to support high quality

audit. Auditors ability to use audit technology will depend on audited entities being able to provide access to data that meets those standards.

5.2. Question 10: Do you agree that threats to auditor independence may arise through the provision of wider business insights (not as part of the audit itself) drawn from the interrogation company data? If so, what measures would mitigate this risk from crystallising?

- 5.2.1. Yes, we agree. However, this threat would be the same as the provision of wider business insights from any aspect of an audit and there should be enough auditor independence requirements that mitigate against such threats, whether the interrogation of company data is through technology or manually.
- 5.2.2. With the spotlight on auditor independence and the unacceptability, in terms of the public interest, in relation to cross selling from audits, it is hard to imagine this risk crystallising. We imagine that the laws and terms of engagement around professional confidentiality of audit information should also mitigate against this risk.
- 5.2.3. Auditors' reputations would be seriously damaged if shareholders or any other interested party discovered that wider business insights derived from audits compromised any auditors' independence.

6. Audit documentation

6.1. Question 11: Do you agree that audit documentation can be more challenging when an audit has been conducted with automated tools and techniques? If so, please identify specific areas where is a problem.

- 6.1.1. Unless we are missing something, we do not agree. Similar issues will arise for business technology and trying to understand and assess the integrity of that technology and the IT and/or other controls in place to try and ensure that integrity. Auditors should be able to produce required audit documentation on the technology, like any other documentation around technology. If there are problems, they should not use the technology until they can produce the documentation.

7. Data analytic exceptions

7.1. Question 12: Have you encountered challenges in dealing with the volume of 'exceptions' arising from the use of more complex or comprehensive data analytic procedures?

- 7.1.1. We cannot answer this question as it appears to be for auditors using more complex or comprehensive data analytic procedures.
- 7.1.2. However, as shareholders in audited entities, we would expect any volume of exceptions to be followed up appropriately to allow auditors to be confident in their audit opinions. If this is a challenge, we would expect the auditor to be allowed the resources for the appropriate follow up and to charge accordingly within reason.

8. Use of third-party technology providers

8.1. Question 13: Do you agree that the use of third-party technology vendors raises potential ethical challenges for auditors and, if so, which potential safeguards would you see as effective in reducing this threat to an acceptable level?

8.1.1. Yes, we agree that potential ethical challenges will arise, but these should be like those of a company using third party technology software for their accounting records and financial statements and therefore safeguarded against in similar ways. These safeguards should include those referred to above in relation to proprietary software.

8.2. Question 14: Do you agree that the increasing usage of third-party providers presents challenges in audit documentation and, where relevant, how have you dealt with this?

8.2.1. No, we do not agree, because based on our understanding expressed at 8.1.1 and 6.1.1 above, we believe audit documentation for both proprietary and third party audit software should not be insurmountable.

8.2.2. We cannot answer the question about dealing with any challenges as we are not auditors using third party software.

If you wish to discuss our response further or require any clarification, please call Charles Henderson on 07709 465772 or Sue Milton on 07500 945978.

Yours sincerely

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