

August 2, 2018

Mr. Jonathan Bravo  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
28006 Madrid  
Spain

***RE: IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality***

Dear Mr. Bravo,

CFA Institute,<sup>1</sup> in consultation with its Corporate Disclosure Policy Council (“CDPC”)<sup>2</sup>, appreciates the opportunity to comment on the *IOSCO Consultation Report on Good Practices for Audit Committees in Supporting Audit Quality* (the “Consultation”).

CFA Institute is comprised of more than 133,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

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<sup>1</sup> With offices in Charlottesville, New York, Hong Kong, London, Mumbai, Beijing and Abu Dhabi, CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 125,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

### **Important Role of Audit Committees**

CFA Institute agrees that audit committees can play an important role in promoting and supporting audit quality and thereby contribute to greater confidence in the quality of information in the issuers' financial reports. Audit committees play an essential role in protecting the interests of investors by overseeing a company's financial reporting process. We agree that, "The good practices report can therefore assist audit committees in considering ways in which they may be able to promote and support audit quality."

Given recent findings by audit regulators, especially the International Forum of Independent Audit Regulators (IFIAR), of the need to improve audit quality and increase the consistency of audit execution we believe the Consultation is an important first step towards that end.

Per the IFIAR Report on 2017 Survey of Inspection Findings:

"Inspections performed on firm-wide systems of quality control address those policies and processes established by audit firms that affect the quality of their audits, including by monitoring for compliance with independence requirements. Though there has been some variability year to year in rate of quality control inspection findings, a definitive trend has yet to emerge ... IFIAR regards the continued frequency of quality control findings as an indication that further improvement is needed."

"Inspections of individual audit engagements assess an audit firm's execution of auditing standards on a selected audit.<sup>3</sup> IFIAR's survey collects data on inspections of listed PIE (public interest entities) audits and audits of systemically-important financial institutions (SIFIs). While the 2017 survey indicates a modest decrease in the rate of audits inspected with at least one finding on an overall basis, a closer analysis of the data highlights a troubling trend of inconsistent progress among IFIAR Member jurisdictions."

"IFIAR Members reported findings from their inspections of 918 audits of listed PIEs performed by 120 audit firms. Forty percent of the audits inspected had at least one finding."

In view of these findings we believe that while this Consultation is a good first step, more needs to be done to ensure high quality audits are performed, especially given good practices are not enforceable.

### **Proposed Good Practices**

CFA Institute agrees with the proposed good practices for audit committees. We believe they will facilitate audit committees in being more effective in promoting and supporting audit quality. Furthermore, we agree with providing good practices at a principles level without including detailed procedures to support those principles given jurisdictional differences in the responsibilities of audit committees. Finally, we believe that the proposed good practices can promote greater consistency in the practices of audit committees within and across jurisdictions.

In particular, we support the proposal that "non-executive directors – who focus on the need for audit quality and who have direct accountability and fiduciary responsibilities to the members/shareholders – should ideally manage the process of developing a recommendation on

selecting, appointing and replacing auditors and the process of determining their remuneration.” We agree that selection criteria should be set at the start of the selection process and focus on audit quality.

We also support the proposed good practices for facilitating the audit process, assessing auditor independence and communicating with the auditor.

CFA Institute strongly believes that the audit committee should,

“Evaluate whether the audit fees charged by the auditor appear adequate in relation to the work required to support an audit opinion without regard to fees that might be paid to the auditor for other services” and,

“Audit fees are consistent with the auditor’s overall plan and are sufficient to support the execution of an appropriately resourced and effective audit.”

We agree that the audit committee should,

“Oversee establishment of the issuer’s policies governing the circumstances in which contracts for the provision of permitted non-audit services can be entered into with the auditor and the procedures that must be followed before doing so.”

But instead of the audit committee simply considering “implementing a policy that all non-audit services to be provided by the auditor must be approved in advance by the audit committee”, we believe good practice would be to implement the policy.

In addition, we believe the following good practices be added to those proposed in the Consultation. The audit committee should:

- Be very conversant in the operations of the business and its competitive environment. This includes having a good understanding of how peers are dealing with common business, audit and accounting issues. Otherwise, key areas of audit risk may not be apparent to the committee.
- Be prepared to get into detailed discussions/challenges with the external auditors on key issues such as impairment tests, depreciation assumptions, and revenue recognition.
- Be proactive in monitoring all external investor communications and securities filings.
- Ensure that investors know that there is an open door for inbound communication to the board chair and audit committee chair.
- Ensure that contact with audit firm client service partners is limited such that audit quality does not get subrogated to the audit firms “client service” or financial interests.
- Discuss with the auditors their views regarding the company’s internal controls over financial reporting.
- Seek the auditor’s views on the effectiveness of the company’s governance process.
- Provide formal evaluations of the auditor as well as regular feedback.
- Disclose how they considered the companies audit fees relative to peers.
- Consider periodically rotating audit committee members, staggering the terms of service to bring in new skills and perspectives.

While we agree that not all audit committee members need to be accounting experts to carry out their responsibilities, the audit committee needs to have sufficient expertise. Further, they should be very proactive in keeping up-to-date with accounting and auditing developments. Also audit committee chairs should include those with recent practical/hands on experience. Many audit committee chairs are former audit firm client service, leadership or relationship partners who are many years removed from having conducted an audit. Investors want those with practical audit experience and industry expertise who can weigh the challenges of the current audit process.

Finally, the audit committee chair needs to spend time outside of committee meetings to meet with the external auditors and to develop a strong, direct relationship. Also, the chair should spend time with the internal accounting and audit staff so that he/she can gain first-hand knowledge of the internal skill sets and culture. “In-house” meetings will help to better understand the internal control culture. Both types of communication help to maintain the primacy of the audit committee and can help to spot potential problem areas.

### **Audit Committee Reporting**

While some jurisdictions require the audit committee to publicly report on how their oversight of the auditor and/or other actions support the quality of the audit, for the majority of jurisdictions there is no mandatory requirement other than reporting on the role of the audit committee in relation to auditor independence.

The Consultation should include a section proposing the public reporting by audit committees on how they support audit quality as a “good practice”. Indeed, in a previous CFA Institute survey the majority of respondents indicated that disclosure to investors of the audit quality indicators that are monitored by audit committees was very important. As the consultation suggests the reporting may include a discussion of the role of the audit committee “in recommending the appointment of auditors, assessing the auditor’s ongoing performance, reviewing audit fees, or other areas.”

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Thank you again for the opportunity to comment on the Consultation. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at [mohini.singh@cfainstitute.org](mailto:mohini.singh@cfainstitute.org) or Sandra Peters, CFA by phone at +1.212.754.8350 or by email at [sandra.peters@cfainstitute.org](mailto:sandra.peters@cfainstitute.org).

Sincerely,

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cc: Corporate Disclosure Policy Council