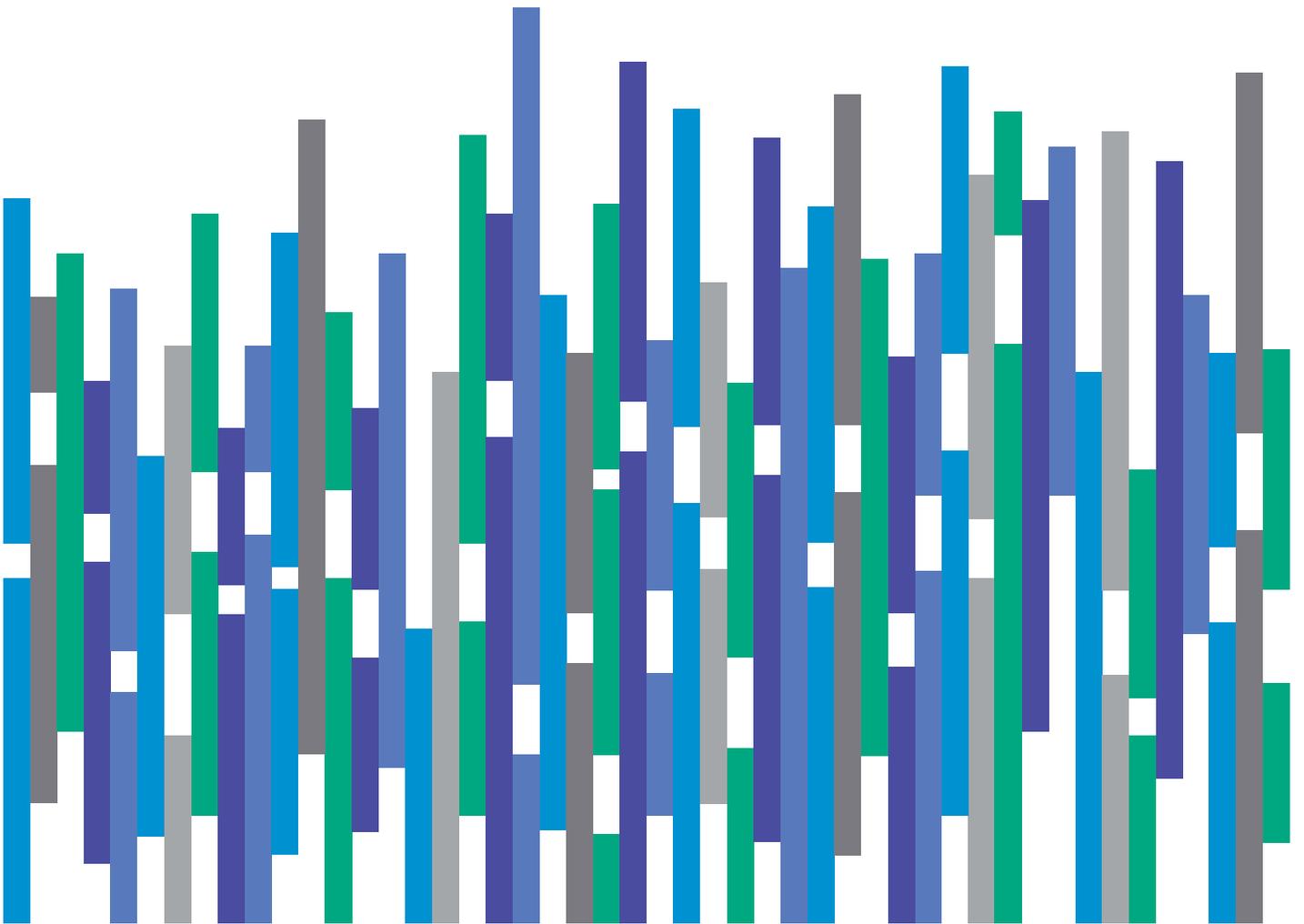




CFA Institute

# CFA INSTITUTE MEMBER SURVEY REPORT

Audit Value, Quality, and Priorities



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## Audit Value, Quality, and Priorities

### EXECUTIVE SUMMARY

This report highlights findings from a CFA Institute member survey to assess factors that influence investor perceptions of the value of audit, factors investors apply when assessing audit quality, and what investors see as audit regulator and standard-setter priorities. Headline findings include the following:

- High quality and insightful communication to investors was the topmost assessed factor influencing investor perceptions of the value of audit.
- Outputs of audit and financial process, including the quality of communication within the auditor report, are considered to be the most important by investors for assessing audit quality.
- Across a selection of 13 topics, the highest priority was assigned to measures that can strengthen the independence of auditors (i.e., independent standard setting and enhanced standards for auditor independence).
- Developing actionable audit quality indicators that enable effective monitoring of auditor effectiveness is a high priority.
- Reasonable support exists for the expanded scope of audit and assurance service, with the expanded assurance for some areas [e.g., consideration of noncompliance with laws and regulations, non-GAAP financial measures (NGFM)] being a higher priority than for others (e.g., auditor comfort on preliminary announcements).

# 1 OVERVIEW

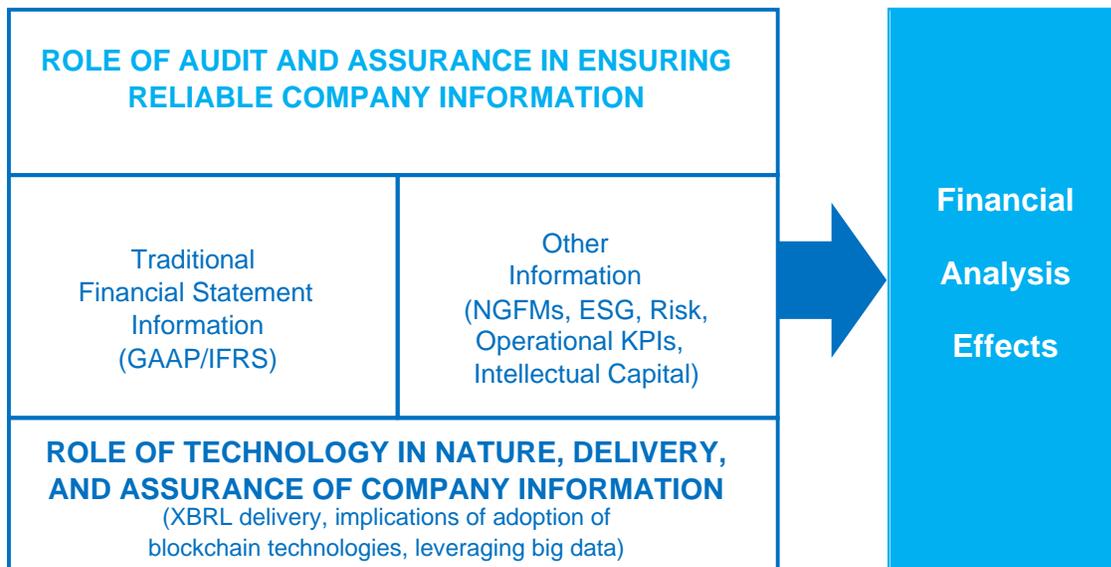
The last 10 to 20 years have witnessed a raft of auditor-related reforms across the globe, including the October 2017 US SEC approval of the Public Companies Accounting Oversight Board (PCAOB) requirements for enhancing the auditor reporting model, a move that aligns with and was preceded by the approval of similar enhancements to the model by the International Audit and Assurance Standards Board (IAASB) in 2016 and the UK Financial Reporting Council (FRC-UK) in 2014. Other audit-related reforms include limiting auditor tenure and prohibiting or placing restrictions on nonaudit services, with a view toward strengthening the independence of auditors.

## VALUE OF AUDIT

Notwithstanding these recent reforms that were aimed at strengthening the usefulness of and stakeholder satisfaction with audit and assurance services, there remains the backdrop of evolving factors that could affect the nature and supply/demand of such services. These factors include the following:

- Investors are increasingly depending on information outside the primary financial statements that is outside the scope of auditor review [e.g., non-GAAP financial measures (NGFMs), financial and operational key performance indicators, and environmental, social, and governance (ESG) information].
- Technology and data innovations could potentially change the nature of audit and assurance services.

As delineated in **Figure 1**, investors' increased dependence on information outside the primary financial statements enhances financial analysis (e.g., forward-looking and supplemental information such as NGFMs). To remain relevant, there is an opportunity—and indeed there have been calls—for auditors to expand the scope and coverage of assurance services. Correspondingly, a pertinent question posed to investors in this member survey was whether scope, among other factors, influences their perception of the value of audit.



**Figure 1: Evolving Audit Factors Relevant for Financial Analysis**

Figure 1 also shows that technology may alter the nature and assurance of company-reported information in a manner that may enhance the value of such information for investors (i.e., to yield more timely, reliable information relevant for financial analysis). Hence, the survey also sought to establish whether certain technology-driven changes in audit methods (e.g., enhanced data analytics in audit testing) affect investors' perceptions of the value of audit.

## **AUDIT QUALITY**

Although the scope and nature of audit and assurance may change, the quest and demand for high audit quality among stakeholders will remain a constant. Defining and measuring audit quality on an ongoing basis can enable regulators, audit committees, and investors to monitor individual firm and auditor client engagement effectiveness, and audit firms to undertake remedial actions where required. Thus, for a number of years, audit quality has been on the agendas of audit standard setters and regulators, as well as audit firms. That being said, no consensus exists across stakeholders on the definition, composition, and measurement of

audit quality.<sup>1</sup> This survey sought to ascertain and elevate investor views on factors that influence their assessment of audit quality.

## OBJECTIVES OF SURVEY

In the last few years, CFA Institute has conducted surveys ([2012](#), [2011](#), and [2010](#)) on audit issues with a predominant focus on eliciting investor perspectives to motivate the enhancement of the antiquated, exclusive pass/fail auditor reporting model. The current survey had a broader focus and sought to assess factors that influence investor perceptions of the value of audit, factors investors apply when assessing audit quality, and what investors see as audit regulator and standard-setter priorities.

The survey was primarily targeted at buy-side portfolio managers and research analysts, sell-side analysts, credit analysts, and corporate financial analysts. The survey had 284 initial respondents. Response rates to the detailed questions ranged from 186 to 211. The Appendix provides additional survey details.

## 2 VALUE OF AUDIT

The member survey findings assessed a subset of seven factors posited to influence investors' perceptions of the value of audit. These factors, reflected in **Table 1**, were arrived at after consulting audit practitioners, regulators, and expert users to reflect what came to the top of their minds when considering the value of audit. No assumption was made that these are the only factors that affect perceptions of the value of audit. In other words, these factors are not exhaustive.

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<sup>1</sup> Accountancy Europe (formerly Federation of European Accountants), *Overview of Audit Quality Indicators Initiatives: Update to December 2015 Edition* (2016), [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). The Accountancy Europe publication identifies nine audit quality initiatives being evaluated across different jurisdictions.

**Table 1: Factors Influencing Investors’ Perceived Value of Audit**

Value of Audit Factors	Respondents	1=Not imp	4=Very imp	Avg
Quality of information contained within the auditor report	211	2.4%	73.0%	3.65
Disclosure to investors of the audit quality indicators that are monitored by audit committees and/or regulators	210	3.3%	57.1%	3.48
Audit firms’ communication to investors (e.g., published audit firm transparency reports)	211	4.7%	58.8%	3.40
Expanded use of data analytics and artificial intelligence while conducting audits	211	5.2%	29.9%	3.02
An expansion of the current scope of audit and assurance services	211	8.1%	30.3%	2.91
Leveraging technology, network alliances, and process efficiency to reduce the costs of conducting audits	211	10.4%	22.7%	2.77
Audit pricing that is either comparable or at a premium relative to the pricing of other advisory, certification, or quality assurance services	209	13.9%	16.7%	2.66

1=Respondents who rated the factor as “Not important”; 4= Respondents who rated the factor as “Very important”; Avg = Average rating of 1–4 score, excluding respondents who had no opinion.

The results in Table 1 show the factors in descending order of the average score based on respondents’ rating of individual factors from 1 (not important) to 4 (very important) and excluding those with no opinion. Varied degrees of importance are assigned to the factors that can influence investors’ perceptions on the value of audit. The following inferences can be drawn from these results:

- ***Insightful communication to investors is the topmost factor influencing the perceived value of audit.*** The results show that the quality of firm and engagement-level communication, including the information contained within the auditor report, the disclosure of audit quality indicators applied in the auditor oversight role by audit committees and regulators, and audit firm transparency reports, were rated top in the subset of factors that influence investors’ perceptions of the value of audit.

This conclusion is affirmed by the responses to the question on importance of factors considered in assessing audit quality (see Section 2, Table 3), which show the importance of communication that enables judgment on audit quality as it influences the value investors derive from audit.

- ***The role of technology in enhancing audit quality is a more pertinent consideration than its role in reducing the costs of conducting audits.*** The results show that although it is not the most important factor influencing perceptions on the value of audit, the expanded use of data analytics and artificial intelligence while conducting audits is quite important (with an average score of 3.02 on a scale of 1 to 4, signaling moderate to high importance). Leveraging technology to reduce the costs of conducting an audit had an average score of 2.77, signaling a moderate to lower importance than that assigned to enhanced data analytics. In effect, the role of technology in enhancing audit quality is a more pertinent consideration for investors than its role in reducing auditor costs.

An excellent article by Deloitte partner John Raphael<sup>2</sup> lays out the possible enhancements in audit methodology and audit evidence gathering that are driven by the development of different strands of technology and data analytics, ranging from artificial intelligence and machine language programming to workflow automation, enhanced analytics, and mobile technologies. The possibilities that enhanced technology and data analytics present to auditors include enhancing business risk assessment, the potential to focus on providing companies with value-added business insights, the scope to extend the level of audit testing with a more effective identification of anomalies, and the opportunity to eliminate several routine and manual aspects of gathering audit evidence (e.g., dispensing with the need to conduct physical stock takes and eliminating the need for auditors to pore through huge volumes of contractual documents). In effect, developments in technology and data analytics can be drivers of enhanced audit quality.

The results of this survey also indicate that some investors have modest expectations or perhaps indifference to the added value of technology in the audit process. Only 22.7% considered leveraging technology to reduce costs as very important and 10.4% considered it not important. As result, auditors need to continually communicate to

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<sup>2</sup> John Raphael, "Rethinking the Audit," *Journal of Accountancy* (1 April 2017), [https://www.journalofaccountancy.com/issues/2017/apr/rethinking-the-audit.html?utm\\_source=mnl:cpainsider&utm\\_medium=email&utm\\_campaign=17Apr2017](https://www.journalofaccountancy.com/issues/2017/apr/rethinking-the-audit.html?utm_source=mnl:cpainsider&utm_medium=email&utm_campaign=17Apr2017)

investors and enhance their demonstrations on how technology will enhance the overall audit process.

- **Reasonable importance assigned for the expanded scope of audit.** In this survey, similar to the feedback on technology, the rating on expanded scope did not cause it to emerge as the topmost important factor. Nevertheless, the expansion of the current scope of audit and assurance services had an average weighted importance score of 2.91 (maximum score 4), signaling a reasonable level of importance assigned to this factor.

The responses to the question on priorities for audit standard setters and regulators (see Section 4, Table 3) shed further light on and also highlight the likely varied expectations for the focus on developing assurance requirements for NGFMs, nonfinancial information, and preliminary announcements. Worth noting is that previous CFA Institute surveys show support for assurance on XBRL<sup>3</sup> (50% expect audits at par with the rest of financial statements), NGFMs<sup>4</sup> (80% expect greater assurance than currently provided with 49% expecting audits at the same level as GAAP/IFRS financial statements and 31% expecting assurance on controls to generate NGFMs), and ESG information<sup>5</sup> (69% expect independent verification of ESG disclosures).

The mosaic of multiple CFA Institute survey findings that reveal investors' appetite for expanded scope for audit are consistent with the articulation by FRC-UK Chairman Stephen Haddrill's October 2017 speech<sup>6</sup> on the need for auditors to go beyond a focus on past information. Haddrill noted the following:

*It is time for lawmakers and standard setters, whether at international level or through bodies like the FRC at national level, and through the profession, to ask*

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<sup>3</sup> Mohini Singh, *CFA Institute Member Survey on XBRL (Extensible Business Reporting Language)* (Charlottesville, VA: CFA Institute, 2016), [https://www.cfainstitute.org/Survey/survey\\_extensible\\_business\\_reporting\\_language\\_xbrl.pdf](https://www.cfainstitute.org/Survey/survey_extensible_business_reporting_language_xbrl.pdf)

<sup>4</sup> Vincent Papa, *Bridging the Gap: Ensuring Effective Non-GAAP and Performance Reporting* (Charlottesville, VA: CFA Institute, 2016), <https://www.cfapubs.org/doi/pdf/10.2469/ccb.v2016.n12.1>

<sup>5</sup> CFA Institute, *Environmental, Social and Governance Survey* (Charlottesville, VA: CFA Institute, 2017), [https://www.cfainstitute.org/learning/future/Documents/ESG\\_Survey\\_Report\\_July\\_2017.pdf](https://www.cfainstitute.org/learning/future/Documents/ESG_Survey_Report_July_2017.pdf)

<sup>6</sup> Stephen Haddrill (Developments in Audit event, 25 October 2017), <https://www.frc.org.uk/getattachment/0f4adc61-033f-4f67-ad95-6c34394b6a4f/Stephen-Haddrill-Developments-in-Audit-Speech-251017-FINAL-1.pdf>

*whether audit should be fitted with front-facing halogen spotlights as well as reversing lights.*

- **Audit fee level is a lower-order factor in influencing perception of value of audit.**

Those who considered audit fees that are at a premium or comparable to other advisory and quality assurance services as very important (16.7%) were about the same as those who considered this factor as not important (13.6%), with an average weighted score of 2.66). It appears that the level of audit fees and whether they are higher or lower than other advisory, certification, or verification services does not have a bearing on the perceived value of audit for many investors.

### 3 AUDIT QUALITY

As observed earlier, academics, audit regulators across the globe, and investors have continually grappled with the definition, composition, and measurement of audit quality. Across these groups of stakeholders, audit quality tends to be evaluated based on input, process, output, and contextual factors, albeit with a differing emphasis on each of these broad factors. Knechel, Krishnan, Pevzner, Shefchik and Velury (2013)<sup>7</sup> elaborate on these factors:

- **Input factors.** Audit is a knowledge-based professional service that depends on inputs. Input factors encompass the values, ethics, and attitudes of practicing auditors, which are influenced by the culture of their firms; they also cover the knowledge, skills, and experience of auditors as well as the time allocated to complete the audit.
- **Process factors.** Audit is a systematic activity where process matters. At the same time, each business/client engagement is unique with respect to its business plans, risks, accounting systems, and management incentive systems. Professional judgment determines how the audit process should be applied depending on differences in client attributes. The quality of audit depends on the quality of auditor judgment in each phase of the audit process (e.g., when assessing risk, performing analytical procedures, obtaining and evaluating audit evidence). Process factors that affect

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<sup>7</sup> W. Robert Knechel, Gopal V. Krishnan, Mikhail Pevzner, Lori B. Shefchik, and Uma K. Velury, "Audit Quality: Insights from the Academic Literature," *Auditing: A Journal of Practice & Theory*, Vol.32, Supplement 1 (2013): pp 385–421.

auditor judgment during the client engagement include audit methodologies and quality control procedures.

- **Output factors.** These factors include financial reporting and audit process-outcome factors such as restatements, fraud, useful information within auditor communication/opinions, quality of financial reporting and disclosure, and regulatory inspection deficiencies.
- **Context factors.** These factors directly influence audit inputs (e.g., incentives and pressures) and process (judgments and evidence evaluation) and indirectly influence audit outcomes (e.g., accuracy of audit reports and financial reporting quality). Examples of contextual factors include audit partner compensation, nonaudit fees, audit fee premiums, and auditor tenure.

Although there is consensus and recognition of the importance of considering the combination of input, process, output, and context factors while assessing audit quality, different parties assign varied degrees of emphasis and importance to each of these broad factors. The academic literature<sup>8</sup> and investors generally give more weight to output factors, in part because these tend to be more readily observable. On the other hand, auditors tend to define audit quality in terms of compliance with professional audit standards.

As outlined in **Table 2**, the survey question sought member views on a combination of input, process, output, and context factors. The specific factors were selected after reviewing the academic<sup>9</sup> and practitioner literature<sup>10</sup> and consulting audit practitioners and expert users. These factors are not intended to be exhaustive.

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<sup>8</sup> Knechel et al. (2013) describe the traditional academic definition of audit quality as “the market-assessed joint probability that a given auditor will both discover a breach in a client’s accounting system and report the breach.” In effect, audit quality has two components: (1) the likelihood that an auditor discovers an existing misstatement—and this links to auditor competence (heavily influenced by input and process factors); and (2) the auditor appropriately acts on the discovery (i.e., displays objectivity, professional skepticism, and independence) and influences output factors.

<sup>9</sup> Knechel et al, 2013; Brant E. Christensen, Steven M. Glover, Thomas C. Omer, and Marjorie K. Shelley, “Understanding Audit Quality: Insights from Audit Professionals and Investors” (working paper, Texas A&M University, Brigham University, and University of Nebraska-Lincoln 2014).

<sup>10</sup> Accountancy Europe (formerly Federation of European Accountants), 2016.

**Table 2: Factors Influencing Investors' Perception of Audit Quality**

Audit Quality Factors	Factor	#	1=Not imp	4=Very imp	Avg
Reported episodes of fraud within audited companies	Output	186	0.0%	78.0%	3.84
Quality of financial reporting disclosures	Output	186	1.1%	64.5%	3.67
Restatement of company financials	Output	186	0.5%	64.5%	3.66
Lawsuits or regulator investigations of auditor due to reporting failures	Output	187	1.1%	56.1%	3.63
Quality of information contained within the auditor report	Output	187	1.1%	62.0%	3.63
Evidence of inconsistent implementation of accounting standards across similar companies	Output	186	2.2%	64.0%	3.62
Bankruptcy or any evidence of financial distress of audited companies	Output	187	2.7%	59.4%	3.52
Securities regulators' significant concerns on reporting issues	Output	187	2.1%	55.1%	3.52
Frequency of change in auditors	Context	187	1.1%	50.8%	3.45
Audit regulator inspection findings	Output	188	1.1%	39.4%	3.45
Audit regulator sanctions and their size and nature	Output	188	1.6%	44.1%	3.43
Industry expertise of audit personnel	Input	188	1.1%	44.7%	3.42
Issues of ethics in nonaudit services	Input	189	3.2%	45.0%	3.37
Extent to which an independent audit regulator has oversight on audit and assurance services	Process	188	1.6%	36.2%	3.33
Training and accreditation of audit personnel	Input	188	2.1%	38.3%	3.27
Quality of audit committee reporting and other communication to investors	Process	187	2.1%	37.4%	3.26
Auditor use of experts such as valuers, tax specialists, actuaries, and surveyors	Process	187	2.7%	36.9%	3.25
Quality of auditor oversight on the work of external specialists	Process	188	1.6%	33.5%	3.19
Composition and effectiveness of audit committee	Input/ Process	187	2.7%	35.3%	3.16
Tenure of engagement partner	Context	188	5.9%	28.2%	3.04
Extent to which nonaudit services are part of audit firm service offerings and have an impact on firm culture	Input	188	5.9%	29.8%	3.02
Extent of use of data analytics and artificial intelligence to determine audit scope, coverage, risk assessment, and detailed testing	Process	189	4.2%	23.3%	2.97
Issues arising within the international, multiple country (if applicable) network of the audit firm	Context	189	5.8%	27.0%	2.97
Audit fees relative to fees charged for nonaudit services	Context	189	7.4%	24.3%	2.86
Number of audit staff per audit partner	Input	187	5.9%	18.2%	2.80
Size and cross-border reach of audit firms	Input	189	8.5%	21.7%	2.80
Audit firm recruitment and retention practices	Input	189	11.1%	23.8%	2.74
Audit fees relative to peers	Context	187	8.0%	14.4%	2.71

1= Respondents who rated factor as "Not important"; 4= Respondent who rated factors as "Very important"; Avg= Average rating of 1–4 score, excluding respondents who had no opinion.

From the results in Table 2, the following inferences can be drawn:

- **Financial reporting and audit process outputs heavily influence investor perception on audit quality.** The survey results (i.e., relative ranking of output versus input/process/context factors) affirm that investors give the most weight to outputs or outcomes of the financial reporting and audit process while assessing audit quality. The results concur with the observations made in the academic literature<sup>11</sup> regarding investor mindset on audit quality.

The results are also consistent with the 2013 PCAOB audit quality indicators consultative paper’s end-user–centric definition of audit quality, which gave more emphasis to outputs by defining them as “meeting investor needs for independent and reliable audits and robust audit committee communications” with respect to financial statements, disclosures, internal controls, and going concern warnings.

- **Lower influence of input, process, and context factors likely influenced by their low related observability.** The lower ranking of input, process, and context factors relative to output factors is most likely due to investors not being able to readily observe the former set of factors. In turn, this signifies the potential role of the audit firms’ transparency reports to, where appropriate, comprehensively communicate these input, process, and context factors.

#### 4 STANDARD-SETTER AND REGULATOR PRIORITIES

Investor expectations on audit standard-setter and regulator priorities were arrived at after consulting audit practitioners, regulators, and expert users to reflect what came to the top of their minds as potential priorities for the related authorities. The 13 issues or topics considered are by no means an exhaustive list of all areas for potential consideration by audit standard setters and regulators. Member views on the priority of these issues and topics are reflected in **Table 3**.

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<sup>11</sup> Knechel et al., 2013.

**Table 3: What should be the audit standard-setter and regulator priority?**

Issue or Topic	Total	High Priority	Medium Priority	Low Priority	Avg Score	Rank by Avg Score
Standards for auditor independence	210	86%	10%	1%	2.88	1
Independence of the governance of audit standard-setting bodies	210	78%	17%	2%	2.78	2
Auditor consideration of noncompliance with laws and regulations	211	73%	20%	3%	2.73	3
Developing and monitoring robust audit quality indicators	209	70%	23%	2%	2.71	4
Audit standards for accounting estimates	209	68%	24%	3%	2.68	5
Going concern judgments and disclosures	211	67%	25%	4%	2.65	6
Audit standards for subsidiary audits	210	57%	30%	6%	2.56	7
Wider adoption of International Standards of Audit (ISAs)	210	52%	27%	8%	2.50	8
Ascertaining appropriate level of assurance on non-GAAP financial measures (NGFMs)	209	51%	33%	8%	2.46	9
Assurance or some other level of auditor comfort on other financial and nonfinancial information	210	44%	40%	8%	2.39	10
Mandatory rather than optional requirements for shareholder ratification of auditor appointment	209	39%	35%	15%	2.26	11
Requiring shareholder voting for audit committee members	210	40%	35%	18%	2.24	12
Assurance or some other level of auditor comfort on preliminary announcements	210	31%	46%	12%	2.21	13

Respondents had four choices: low, medium, or high priority, or no opinion. The weighted average score was determined by assigning 1 to low priority, 2 to medium priority, and 3 to high priority, and excluding respondents who had no opinion.

As the question was not framed to distinguish between what are considered short-term versus long-term priorities, the results likely reflect respondents' views on immediate priorities. From the results in Table 3, the following inferences were drawn:

- **Strengthening independence of audit process is rated as the topmost priority.** The topmost-rated priorities in this survey were standards for auditor independence and the need for a fully independent audit standard-setting process. This finding underpins the importance and desirability of auditor independence and concerns about any institutional and business model features, as well as audit process factors that may undermine auditor independence.
- **Developing ability to monitor audit quality is a high priority.** Developing and monitoring audit quality indicators was one of the top-rated priorities, affirming the importance of a sustained focus on the development of actionable audit quality indicators.

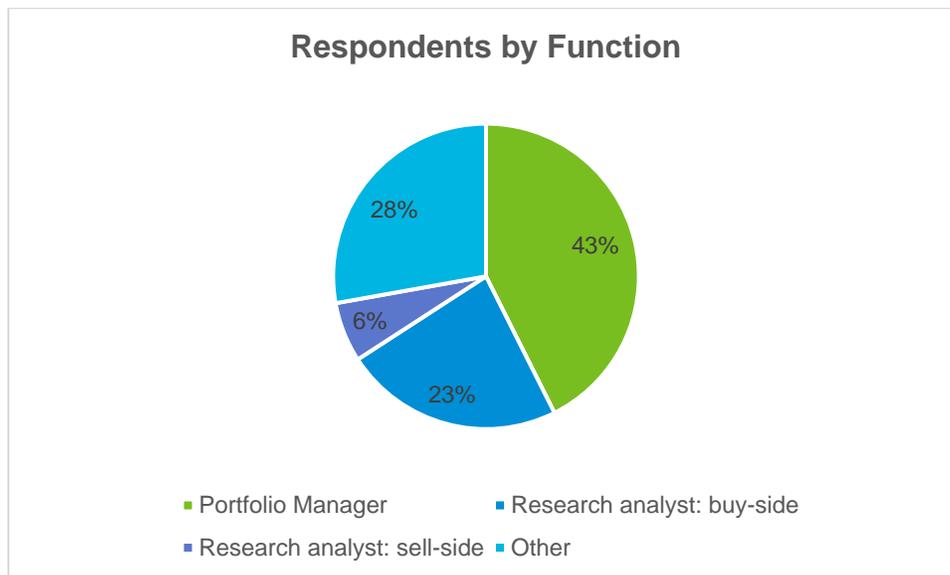
- **Support found for strengthening specific audit standards (accounting estimates, going concern, and subsidiary audits) and wider adoption of ISAs.** The results show high priority assigned to the specific audit standards that the survey sought views on (i.e., accounting estimates, going concern, and subsidiary audits) as well as the wider adoption of ISAs, as shown by a majority of the respondents considering these as being high priority.
- **Support found for expanding assurance for NGFMs and nonfinancial information.** This survey supports previous survey findings as it shows that most respondents considered developing assurance for NGFMs, and financial and nonfinancial information reported outside the primary financial statements to be either a high or medium priority.
- **Timeliness likely trumps need for assurance of preliminary announcements.** The results on the need for some comfort or assurance on preliminary announcements show that it was the lowest priority topic across the set of topics that this survey sought views on: 12% of respondents deemed it low priority and many more respondents considered it only medium priority (46%) rather than high priority (36%). On the premise that investors could be assuming that the need for assurance would hinder the timely release of preliminary announcements, we infer that the desired timeliness of such information likely trumps the need for the related assurance.
- **No strong feeling shown for investors having mandated involvement in audit process.** The results show that there was a low relative priority for either mandating shareholder ratification of auditor appointment or mandating their voting for audit committee members. Those who assigned either a medium or low priority to these two options were more than those who assigned a high priority.

In sum, there is clear support for strengthening auditor independence, enhancing the monitoring of audit quality, strengthening audit standards and broadening the scope of assurance services across a selection of areas.

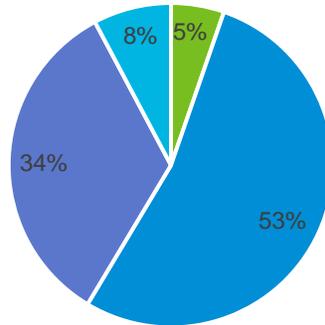
## 5 APPENDIX

### SURVEY PROFILE

The survey administered in July 2017 was primarily targeted at buy-side portfolio managers and research analysts, sell-side analysts, credit analysts, and corporate financial analysts. The survey had 284 initial respondents representing a response rate of 1.3%. Response rates to individual questions ranged from 186 to 211 with a margin of error ranging from 6.7 to 7.1%. Below is a breakdown of respondents by functional area, investment horizon, asset class, investment style, investment technique, and broad region.

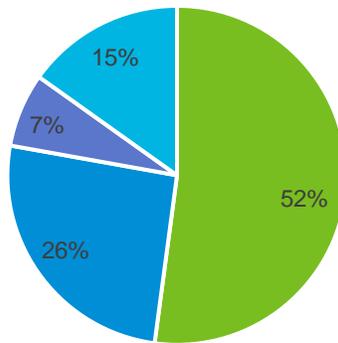


### Respondents by Horizon



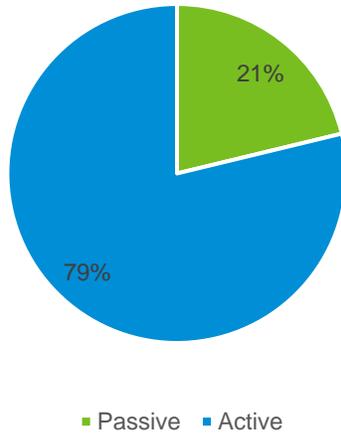
- Short term (one year or less)
- Long term
- Balanced combination of short term and long term
- Not applicable

### Respondents by Asset Class

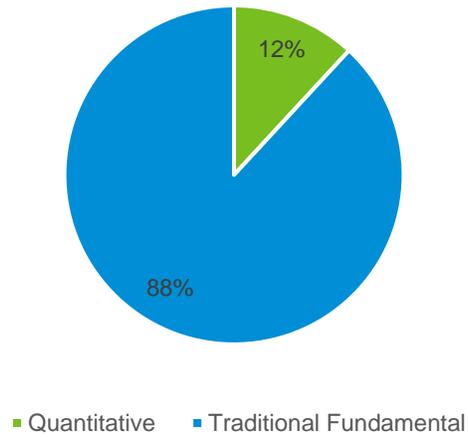


- Equity
- Fixed income
- Private equity
- Other

### Respondents by Investment Style



### Respondents by Investment Technique



### Respondents by Broad Region

