OPENING A DISCUSSION:
THE FUTURE OF AUDIT AND ASSURANCE

RESPONSE FROM ICAS TO FEE

27 June 2014
Background

1. ICAS welcomes the opportunity to comment on FEE’s paper ‘The Future of Audit and Assurance. Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK’s and the world’s great companies.

2. Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General comments

We are pleased that FEE has taken this opportunity to seek to open up the debate on the future of audit and assurance. Considerable time has been spent by the profession in recent years in responding to proposals by regulators which are intended to improve the quality of audit. The benefit of some of these proposals and indeed some of the legal changes which have now been agreed is at best questionable although there have been certain positive developments e.g. the introduction of the requirement for more informative audit reports to be provided by auditors in the UK which will soon be followed the IAASB’s proposed reforms in this area.

In this context the FEE paper is to be welcomed as it provides the profession with an opportunity to help shape its own future and a means with which to engage with key stakeholders to help ensure the sustainability of the audit profession.

Responses to Specific Questions

Questions related to the objectives of opening this discussion

1. How can we respond to expectations in a constructive and realistic manner?

   Before considering how we should respond to expectations, we first have to acknowledge that there are a variety of stakeholders with an interest in corporate reports (and related information) and assurance thereon. These stakeholders have a variety of different needs. The stakeholders range from shareholders (investors) whom in the EU the interests of the audit is specifically meant to serve, to others such as suppliers, creditors and indeed governments. We firstly need to establish the expectations of the key stakeholder groups and assess whether it is possible, and indeed, whether in some cases even desirable to seek to meet those expectations.

   For at least some stakeholder groups (or subset thereof) it can be argued that the primary issue is more of an information gap as opposed to an expectations gap. Developments in certain member states and by the IAASB in relation to more informative audit reports are at least helping to address this information gap to some degree.

   It is therefore vital that the audit profession attempts to build relationships with the aforementioned investors in the first instance to determine and understand exactly what they look for and expect from the audit profession in relation to the provision of assurance. Regular dialogue with regulators is also essential. The profession should always be willing to learn and should seek to innovate wherever possible with the objective of improving audit quality at the forefront of such developments.
2. **How should the profession engage with stakeholders?**

It has proven difficult for audit professionals to engage in any detailed and probing discussions with investors in the past. Investors tend to view audit and assurance as a compliance service largely focussing on historical out of date financial information. The increase in complexity of business and hence financial statements has made it more difficult for investors to interpret how well a business is performing and do nothing to increase confidence in the future stability and prospects of the entity in which they have invested, or are considering investing.

ICAS recognised this limitation in the existing audit and assurance process in our *Future of Assurance* publication in 2010, and recommended that such was the importance of the information in the front half of the annual report that auditors should be tasked with providing a positive opinion on the content of the front-half of the annual report. This recommendation was then explored further in our *Balanced and Reasonable* discussion paper published in April 2013. The feedback and comments on this paper were published in April 2014 and, while there was support for our proposals, a question that featured in many of the responses we received, was whether there was any demand for increased assurance to be provided over management commentary. See: *Assurance on Management Commentary: Where Next?*

ICAS has therefore determined that the natural next step in this debate is to find a way to better engage with investors. To do so we believe it is necessary to better understand the impact of recent changes to the corporate reporting environment in the UK i.e. the introduction of the fair, balanced and understandable requirement. Therefore, we have just commissioned research into a review of the recent changes to corporate reporting in the UK which will involve enquiring of auditors, preparers and companies: what they did differently; what caused them difficulty and whether they perceive that the reporting and assurance requirements could go further still and extend to a positive opinion over the front-half of the annual report. We expect this work to commence in the autumn of 2014 with a report expected to be published in the Spring of 2015.

**Questions related to the section on the professional accountant’s focus in day to-day activities**

3. **Do standards add the intended value or do they inhibit innovation? Are standards becoming too rules-based?**

One advantage that the profession does have is that both auditing and accounting standards are, to a large extent, global standards and used in many different jurisdictions around the globe. Therefore, the existence of such accepted standards should help to drive up the quality of corporate reporting. It also facilitates the movement of professionals across a variety of locations and jurisdictions.

Standards provide a helpful reference point throughout all the stages of an engagement, from planning, through to the actual process and completion. Used properly, they are designed to ensure that the key, significant risks of an entity are adequately considered, identified and addressed during the audit field work. However, it is difficult to produce a set of standards which are appropriate for all sizes of entity; for example: from a small charity to a large complex, multinational listed entity. And this is perhaps where some attention should be focussed: to ensure that the current standards are sufficiently constructed to facilitate proportional application by the smallest of entities. At present, for many of these entities, the audit process is seen as a “box-ticking exercise” which adds little in the way of value.

There is little doubt that that as the length of the standards in both accounting and auditing has increased over the years, the number of requirements has tended to increase. It can be questioned whether such an approach has tended to remove the ability of the auditor to appropriately exercise professional judgment. Minimum standards are necessary and should be seen as a positive but they should not stifle innovation and use of professional judgment. Standards should not be seen by the profession as a means by which to manage the risk on engagements.
4. **Do standards make our profession stand out? Why or why not?**

Many professions use standards as a means of directing and focussing their work and these are likely, similar to our own, to be very specific and, in some instances, extremely technical in nature. It can be argued that it is questionable that anyone outside of the accounting and auditing profession perceives the additional value from a practitioner adhering to a set of consistent standards and good practice; rather, this would be perceived as a foregone conclusion, much the same as in any other profession. Therefore, we do not consider that the application and adherence to a set of standards makes our profession stand out but we envisage that such standards would be considered necessary by regulators, observers and external parties for us to uphold our professional status. On the positive side the existence of near globally accepted standards in both accounting and auditing can be argued to be something that does make our profession stand out.

5. **How can we further develop and demonstrate integrity and objectivity instead of only independence?**

In the UK, trainee professional accountants are given training in the ethical and behavioural qualities associated with being a professional and this features heavily in the education syllabus. However, perhaps there is a need to ensure that these qualitative behaviours and characteristics are further developed throughout an accountant’s professional career. At present, there is no specific CPD requirement which reinforces the importance of ethics and integrity within our profession. In some jurisdictions, ethics is incorporated into the CPD requirements, and some of the firms provide in-house training in this area. Making ethics, objectivity and integrity a CPD requirement for the profession would encourage greater awareness and consideration of these issues in a professional’s day to day working life. Furthermore, this matter is heavily dependent on the culture within the respective audit firms. In order for integrity and objectivity to be at the forefront, then the tone at the top must be such that it is pervasive throughout the firm and across different jurisdictions.

6. **At which level will you be affected by IT innovation in the coming years? If applicable, for which type of services?**

Innovation in IT has had, and is continuing to have a major impact on the way we all live our lives. The evolution of the internet in the last 20 or so years and its impact on society has been incredible. The larger accountancy firms are all investing substantial sums on data analytics tools as firms innovate in terms of developing better methods of auditing large populations of data. Our intelligence suggests that corporates are finding the results of such audit work very useful.

IT innovation will undoubtedly continue to have a major impact on all our members as well as on ICAS as a professional body. From our perspective, ICAS already sees the way in which we engage with our members changing. The developments in IT and virtual / remote technology have facilitated a move to more virtual and online engagement, allowing us to contact our international members and engage with them more closely. This means that we will have to ensure that our services, products and guidance are capable of being accessed via a variety of different means: via tablet; smart phones.

Developments in corporate reporting will also continue apace. Will we end up moving to real-time reporting?

7. **What are your views on the education and training of professional accountants and auditors? Is it fit for purpose? How can we ensure that it will be in the future? How can we develop education to improve the quality of services?**

In today’s business environment, auditors and professional accountants are required to have much broader skills with the introduction of additional services and products, for example sustainability reporting, greenhouse gas emissions etc. They are also expected to have an in-depth knowledge of the business and understanding of the entity and the environment in which it operates. For those reasons, as trainers, we have a responsibility to ensure that our education syllabus equips our future
auditors for the challenges they face in their working lives. Currently ICAS and the FRC are conducting research into the skills and competencies required of the modern auditor with reports due to be published in the coming months. It is hoped that the findings from this research, which consists of two separate projects comparing the UK with (i) Europe and (ii) Australia, South Africa and New Zealand; can inform the development of the education and training syllabus for the auditors of tomorrow.

Professional accountants and auditors will also need to be up to date with IT developments. It is also likely that more focus on the future will be placed on the behavioural characteristics of directors of large PIEs. It can be argued that having a better insight into those running an organisation enables a more effective audit of that entity to be carried out.

8. How can we ensure that we create a new type of auditor who can adapt and react to the current and future business challenges?

As referred to in our response to question 7 above, it is hoped that the findings from our research projects into the skills required for the modern auditor can be incorporated into future training regimes to ensure that the auditor of tomorrow is equipped with the necessary appropriate skills.

Questions related to the section on the focus on the auditor’s communication

9. Do you see merit in further exploring the suggested changes in auditor reporting outlined above?

We would like to consider each of the suggested changes individually.

(a) Introduction of a grading system: There would be some merit in further consideration being given to this proposal. This would require research into the types of information that stakeholders believe would benefit from such an evaluation and the type of information most capable of being evaluated. The development of a system to benchmark these performance areas would require a significant amount of time and effort to ensure completeness and consistency and therefore some form of cost-benefit analysis would be necessary.

(b) More frequent reporting: This would address the issue of the auditor reporting on historical and out of date information and would promote real time feedback from the profession on an entity’s performance and status. It would require greater and more regular contact between the auditor and the entity adding to the perceived value provided by the audit process. However, the nature of some of the information reported in real time, which may be subjective or susceptible to change, may encounter some reluctance from the profession to provide assurance over information of this type. Inevitably such an approach would lead to greater assurance being provided over the systems in place as opposed to over the actual content reported.

(c) Other methods of communication: Greater and novel means of communication between the auditors and other stakeholders, for example shareholders, are to be encouraged and welcomed. The new auditor’s report provides a means by which the auditor can communicate key findings and significant risks to users. Therefore, engaging in more direct oral communications with key stakeholders can only provide greater insight into the process by which the auditor arrived at his/her conclusion and add value to the perception of the audit process. The opportunity for users to ask questions of the auditor directly in such a forum will add to users’ understanding of the way in which the audit was conducted and provide a means of evaluating the auditor’s performance. Care, however, will need to be exercised to ensure that the scope of any questions addressed to the auditor is restricted to their responsibilities.

(d) Greater information about management’s going concern assumptions: The original enhanced disclosures first proposed in the IAASB’s improved auditor’s report were seen as a welcome inclusion in the auditor’s report and therefore the decision not to include this information in the latest proposal is regrettable. Whilst we appreciate that corporate reporting needs to define the going concern concept, the extent of management’s responsibilities and duties to report in this respect have yet to be agreed.
We would like to see auditors take a lead role in improving going concern reporting and disclosures. In the UK, some of the audit firms who have already adopted the FRC’s improved standard on auditor reporting, have included a positive statement on an entity’s going concern status and we would wish to see management adopt a similar approach and report on their assessment of the entity’s ability to continue as a going concern which should include details of the assumptions on which their assessment has been based.

10. **Are there any other areas in which the auditor’s involvement could add value?**

ICAS advocates that investors should be given greater assurance over the front-half of the annual report in the form of a positive expression of opinion by the auditor. This proposal was suggested in our Balanced and Reasonable discussion paper issued in April 2013. We consider that this would be a valuable addition to the reasonable assurance currently provided over the financial statements by enhancing the credibility of the front-half and reducing the risk of the narrative commentary becoming subject to management spin and thus increasing the reliability of the information contained therein.

11. **Do investors want different assurance to banks, to shareholders, to management?**

We are not convinced that many stakeholders are able to differentiate between different types of assurance. Whilst it can be argued that there is definitely an education exercise for the profession we believe that in the first instance there is a need for consideration to be given to revising the profession’s assurance framework which was developed by the IAASB. We believe that at the moment the framework does not adequately convey the different between reasonable and limited assurance. Additionally, we believe that stakeholders do not value opinions which ineffect contain a double negative. Therefore, we believe that consideration should be given to the development of a framework that:

- Allows professional accountants to issue positive opinions with different levels of confidence; and
- That is clear to users what the differences are in the types of report that may be issued.

12. **Should the recipients of the audit report be more clearly defined?**

Currently, the auditor’s report is addressed to the members only and, in the UK, a specific paragraph is generally included as part of an audit firm’s risk management process to emphasise that the auditor’s report is intended only for those to whom the report is addressed, most commonly the members, as per the judgement in the case of *Royal Bank of Scotland v Bannerman Johnstone Maclay*. Some view the inclusion of this wording as reflecting negatively on the profession (disclaimer) but to others it is merely transparent in highlighting the extent of the auditor’s duty of care to those reading the report. The law in the UK is clear that the audit report should be addressed to the shareholders of the entity. If consideration was to be given to potentially extending the addressees beyond the entity’s members then this would require very careful consideration of the current auditor liability regimes to which the auditor is subject in different EU member states and whether the reporting responsibilities might be expanded without exposing the auditor to increased risks of litigation from third parties. As far as recipients of the audit report is concerned, this information is in the public domain and therefore, anyone, including individual potential investors, could be considered to have an interest and, as a result, a potential recipient. It would be therefore be almost impossible therefore to define and identify all possible recipients so, for that reason, we are not in favour of widening the specific addresses of the audit report.
Questions related to the focus on alternatives to better meet stakeholders’ Needs

13. According to your view, what range of services could be developed?

When considering the range of services and alternatives to better meet stakeholders’ needs, it is important to engage with key stakeholders, for example investors, to ascertain the types of services they would value and welcome. As previously mentioned, ICAS intends to conduct research in this area to identify the value that investors attach to the assurance service they are currently receiving and how this might be enhanced and developed to increase the usefulness of the information they receive. This is the key initial step at this stage before identifying and promoting new products and services which will only further confuse stakeholders and dilute the value of the current assurance model.

Additionally, not all successful products are identified as such at the market research stage. The profession must therefore also seek to enter into dialogue with investors and other key stakeholders as to what types of service may better meet the needs of these groups. That is why this FEE initiative is so important.

14. How can FEE be instrumental in further developments in this area?

In our opinion, FEE can act as an information gatherer and distributor, reporting and updating on the main initiatives and projects underway globally which are considering the future of the assurance process and how it should evolve. Facilitating contact and collaboration between different jurisdictions on joint projects would be a possible additional role for FEE. Anything that FEE can do to facilitate discussions and interaction between interested parties, including investors, corporates and regulators would be welcome across the profession.

15. Is there a need to consider alternatives to statutory audit for SMEs?

The current ISAs are focussed towards larger and more complex entities and therefore are of less value to SMEs. With the potential to increase the audit threshold further in member states, more of these entities may find that they no longer require an audit in its current form. Therefore, that does beg the question as to what should replace the statutory audit. The range of alternatives to be provided will depend upon the parties that place reliance on the financial statements. One of the key groups is lenders, who will base the continuation and enhancement of loan facilities on the financial statements and many bank covenants currently include a clause requiring the entity to undergo a statutory audit, regardless of whether the entity concerned falls below the threshold. It is not yet clear the extent to which the inclusion of such clauses is likely to be continued in future lending arrangements.

So before considering the range of alternatives to the statutory audit, we need to consider what information these user groups actually seek comfort over. In many cases, for example HMRC, their expectation is likely to extend as far as the accuracy and reliability of information and disclosures in the financial statements. For others, for example customers; suppliers; lenders; they will seek reassurance on the entity’s ability to continue as a going concern. We should then consider whether there are currently products available which will meet these expectations before crowding the market with a new suite of products which is likely to cause further confusion for users.

ICAS currently produces best practice guidance on an accounts preparation engagement: Framework for the Preparation of Accounts. This guidance, although not prescriptive, requires that an accounts preparation engagement is undertaken in accordance with the ICAS Code of Ethics and complies with the relevant reporting framework. This means that a chartered accountant should not be associated with accounts which they consider to be misleading. The ultimate sanction available to the practitioner is withdrawal from the engagement. The guidance also requires accountants to obtain a sufficient understanding of the entity and maintain an objective and questioning attitude to management’s estimates and judgements.
The framework emphasises management’s responsibility to prepare accounts on a going concern basis unless inappropriate and the auditors’ responsibility to ensure that the accounts are not misleading gives some comfort to users over the going concern status of the entity. The chartered accountant’s signature at the foot of the accountant’s report gives further comfort on the reliability of the information in the financial statements.

There are other jurisdictions with similar guidance and best practice therefore ICAS does not consider it necessary to develop alternative products and services, but sees a need to better inform users and promote those products currently available.

16. **How could the range of service offerings be adapted in order to meet current and future needs in the SME environment?**

As referred in our response to question 15, some jurisdictions currently produce guidance and services being used by those SMPs acting for SMEs, therefore this guidance is unlikely to be in need of adaptation for the SME market. Undoubtedly greater focus has been placed on seeking to forecast the future prospects of such entities as opposed to providing assurance on past performance.

17. **Is the profession too focused on financial information?**

Whilst undoubtedly having a key role, on balance the profession is probably too focussed on financial information. What investors appear to want is for annual reports to tell them a story about how the company is performing and what plans it has for the future. Investors are increasingly therefore focussing on the content of the front-half of annual reports. The complexity of financial statements has also probably compounded this focus on management commentary. Therefore, ICAS strongly supports a shift towards the profession providing greater assurance on the content in the front-half of the annual report. We believe that the needs of stakeholders would be best served by auditors providing a positive opinion on the content in the front half. This was the focus of our Balanced and Reasonable discussion paper as referred to previously. The profession is currently more familiar and comfortable with the concept of assurance on financial information which is quantitative and more capable of verification and substantiation than with the idea of providing assurance on qualitative information. Indeed with the increased level of subjectivity on certain information contained in the financial statements auditors are already being tasked with providing assurance over more subjective information. Additionally, the increase in sustainability reporting and related assurance has also seen the profession become more comfortable with assessing narrative information which is more subjective in nature. So we welcome the shift in the auditor’s focus from the financial information towards a greater focus on the narrative disclosures and envisage that this move will continue to evolve over time.

18. **Is there a market demand for assurance on narrative reporting in annual reports? Why (not)?**

As stated in our response to question 2, this question featured in many of the responses we received to our Balanced and Reasonable discussion paper. As mentioned, we have commissioned research into the usefulness and value of the current corporate reporting and assurance regimes and whether the assurance provided needs to go further. The research will be approached from the perspective of auditors, preparers and companies to facilitate a wider discussion with users based on the findings and results of this research.

We also appreciate the assistance that FEE gave to us in the hosting of a joint event on this topic in Brussels in 2013. Such high level events provide an ideal opportunity to have constructive dialogue on matters which are crucial to the profession and to those served by the profession including the capital markets.
19. **Will the market demand assurance on CSG, ESG and <IR> as this type of reporting becomes more widespread? Why (not)?**

Currently, there are organisations already providing assurance on CSR, ESG and Sustainability reports as it is acknowledged that the subjective nature of their content makes them more reliable and credible if they have been subject to an external review by a third party. As we see more reports being published in the marketplace over which assurance has been sought, it is probable that the market will start to demand that assurance is received over such content to enhance the credibility of the reports. Likewise, more preparers are beginning to appreciate the benefits of having such reports assured. What is uncertain, however, is whether going forward that assurance will be limited or reasonable in nature.

20. **How can the profession help public sector entities achieve high-quality financial reporting?**

In order to help public sector entities achieve high-quality financial reporting, ICAS supports:

- The use of accruals based accounts;
- Alignment with one international accounting framework for both the profit and not-for-profit sectors unless there is a clear, justifiable need of a material public sector specific matter which is not covered by the IASB;
- A “principles based” approach to addressing public sector accounting differences in a proportionate and targeted manner;
- Simplification and greater transparency of public sector reporting including matters of public interest, to hold decision makers to account more effectively (Transparency); and
- We are also supportive of more informative corporate reports from such entities and not just in terms of the financial reporting aspect.

We would emphasise that we are not supportive of any EU specific solutions such as EPSAS which have been proposed by Eurostat.

The profession in its widest sense has a key role to play because professional accountants are employed as financial directors, serve as non-executive directors on the boards of such entities and indeed audit public sector entities. By working together with stakeholder groups professional accountants from these different groupings can help to shape the development of public sector corporate reporting to ensure that it better meets the needs of the end user.

Additionally, there is also value that can be provided by the profession outside of the normal financial reporting mandate, e.g. value for money assessments etc.

**Question related to the conclusion**

21. **What additional points should be considered in this debate?**

It is essential that the profession seeks to work together with stakeholders to ensure that it remains relevant and has a sustainable future. This year marks the 160th anniversary of the founding of ICAS, and indeed the accountancy profession. Only by living up to the challenges that society poses, can we ensure that the profession retains its relevance that we have enjoyed over our proud history.