

ACCOUNTANCY FUTURES

Value regained: restoring the role of audit in society

ROUND-TABLE DISCUSSION IN MALAYSIA, 22 SEPTEMBER 2010

ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 140,000 members and 404,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

ABOUT ACCOUNTANCY FUTURES

The economic, political and environmental climate has exposed shortcomings in the way public policy and regulation have developed in areas such as financial regulation, financial reporting, corporate transparency, climate change and assurance provision.

In response to the challenges presented to the accountancy profession by this new business environment, ACCA's *Accountancy Futures* programme has four areas of focus – access to finance, audit and society, carbon accounting, and narrative reporting. Through research, comment and events ACCA will contribute to the forward agenda of the international profession, business and society at large.

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This report summarises one of an international series of round-table discussions hosted by ACCA and designed to generate debate, new ideas and recommendations about the future of audit.

In 2010, ACCA chose 'audit and society' as one of four critical issues which it is addressing under its '*Accountancy Futures*' programme.

ACCA believes firmly that audit has a key role to play in society as a source of public confidence in financial reporting but notes that there is currently little published research which seeks to demonstrate its value. By bringing together a wide range of market participants, we hope to help establish ways in which the value of audit can be enhanced for all stakeholders.

FURTHER INFORMATION

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BACKGROUND

The round table in Malaysia was the final one in the global series of ten events held by ACCA to ascertain the views of market participants on the value of audit. Speakers, a list of whom appear at the end of this report, included representatives from audit firms, investors groups, regulators, academia and professional accountancy bodies.

ACCA intended the following issues to shape the discussion.

- In what ways do stakeholders think that the audit report enhances the credibility of a company's financial statements?
- Do participants think the audit adds value to business as currently constituted?
- In the light of the financial crisis, is it time for the audit profession to consider radical changes?
- If so, what additional value do stakeholders consider should or could be provided by the audit?
- Would companies and their shareholders be prepared to pay more for expanded audit work? Do they think that paying more for the audit would better serve their interests, in the sense that it would improve the quality and value of the audit?

CONCLUSIONS

Auditors must live up to the spirit as well as the letter of audit and ethics standards and demonstrate independence and scepticism. As for business generally, ethical behaviour is essential if principles-based regulatory systems such as professional oversight of auditors, are to succeed.

Audit findings need to be communicated more widely. Shareholder representatives wanted more information on risks from the auditors, rather than boiler-plate statements.

Shareholder groups wanted to see more interim audit reports so that 'red flags' could be waved for investors if the company started hitting problems. Behind the scenes raising of concerns by auditors to management was no longer sufficient.

Audit firms need to price audit work based on risk and complexity, not just on time spent. On the other hand, audit committees should not focus simply on driving down audit fees.

Large non-audit fees were regarded as a threat to auditor independence.

ETHICAL ISSUES SURROUNDING THE VALUE OF AUDIT

It was agreed that auditors – along with other players in the financial reporting chain such as accounts preparers - need to meet the spirit as well as the letter of audit and ethics standards. ACCA would agree that any system of standards which are principles-based rather than rules-based depend on people of good ethical standing applying them. The audit regulator exists to assure shareholders and everyone with an interest in the efficacy of financial reporting that companies' financial statements can be treated with confidence. So the challenge for auditors is to ensure they are doing not just what is legally acceptable but that which is morally right.

Scepticism is a key part of good auditing. Just as in the UK, where the regulatory authorities have launched inquiries as to whether sufficient scepticism was shown by bank auditors in the lead-up to the financial crisis, so in Malaysia the regulators are unconvinced that audit firms have challenged management on issues such as valuations of assets and properties in the way they should have done. There is even a view that auditors have gathered evidence to support company assertions rather than questioning them. Some shareholder representatives argued that the regulators had not done enough to clamp down on errant auditors.

EXPANDING THE ROLE OF AUDIT?

Shareholders were clear that they 'wanted more' from auditors than they currently received. Echoing concerns expressed by their counterparts in other countries in earlier ACCA round tables, they complained of boiler-plate reporting when what they needed from auditors was information on risk in the companies and what they thought of them. Communication of audit findings has proved to be a big issue in the ACCA series and in Malaysia investors' representatives wanted to be given risk information even if it had to go to the audit committees first.

They also wanted to see pertinent information contained in the management letter. One asked for 'red flags' to be raised if the company was hitting problems and for shareholders to be alerted if auditors were bringing issues to management. They also called for more reviews and interim audits – not necessarily continuous or real-time audits which have been raised in other round tables but certainly more than an annual audit. It was also mentioned that for bank audits, the Malaysian Central Bank puts more store on the long-form report it receives than the final two-page report signed by auditors, so the market in Malaysia is not immune from the concept of the management letter going to external stakeholders.

The audit firms themselves are frustrated that considerable amounts of work is distilled into a short stilted statement which is not an accurate reflection of the effort expended. The technical language used also perhaps puts people off although given that accounting has become more subjective (notably fair value) some feel that investors do not pay enough attention to the judgments in the annual reports. They did however raise the issue of potential litigation if management letters were released more widely and certainly this issue would have to be addressed before any such change were made.

COSTS AND VALUE OF AUDIT

But would companies be willing to pay more if the currently constituted scope of audit were enhanced? Minority shareholder groups said they advised their clients not to be obsessed with trying to reduce audit fees as ultimately you get what you pay for and too low fees will mean the value of audit is reduced. The firms were worried that too many talented staff were being lost to the profession because the money was not there to keep them. On the other hand, auditors were warned that they needed to be sharper when it came to charging their fees according to risk and complexity of work, not based on time spent. Audits should be priced properly and not commoditised.

Audit firms insisted however that when considering the value of audit, people should remember the 'invaluable' benefits of audit that shareholders might not see, such as the identification of issues that affect financials. Auditors challenge management and these issues get raised at board level. There is intangible feedback on the strength of the finance function and internal controls. In the case of multinational companies' (MNCs') audits, auditors also play a role by pulling together input from all parts of the world and feeding it back to the centre.

The firms accepted that to be really valuable, auditors need the strength to speak their mind in order to challenge management and deliver robust work. The value of audit will always be clearly interlinked with the value of financial statements themselves, even if the role is expanded. In summary, they said, there is still a lot of value and it should be remembered that thousands of audit opinions are being issued globally, but audit failures are a small proportion. The market still had confidence in audit, for all the concerns that were being expressed at the round table.

Reference was also made to research carried out by ACCA in neighbouring Singapore, in which audit committee chairmen were interviewed and most believed that auditors added considerable value, particularly on issues like interpreting new accounting standards and were sufficiently sceptical and independent. They also added real value in terms of feeding back on the quality of the management team and identifying potential problems.

AUDIT INDEPENDENCE AND NON-AUDIT FEES

There was a divergence of views on this issue. Some took an absolute view that any non-audit work hindered true independence on the audit approach while others drew the line at internal audit work or due diligence work. Most agreed that non-audit fees should not be too high as it was a problem when it exceeded the audit fee. ACCA's own view is that companies should be sensitive to this situation and understand the issue of external perception. Independence safeguards were questioned as being insufficiently visible.

There was general agreement that accountancy profession needed to do a better job in terms of explaining not only its role (in terms of the so-called audit 'expectations gap') but also in terms of the ethics requirements of their members. There was concern that there did not appear to be sufficient deterrent for bad auditing. But in conclusion, investor representatives reaffirmed the value of audit and that it did give them assurance on company financials.

ACCA would like to thank the following individuals for their participation in the round table discussion in addition to the ACCA members and other people who attended the event.

MODERATOR

Mr Robert Stenhouse, ACCA Global Council Member, Director, National Accounting and Audit, Deloitte LLP UK

PANEL REPRESENTING VARIOUS STAKEHOLDERS IN AUDIT

En Abdul Rahim Abdul Hamid, President, Malaysian Institute of Accountants (MIA)

En Nik Mohd Hasyudeen Yusoff, Executive Chairman, Audit Oversight Board, Malaysia

Ms Rita Benoy Bushon, CEO, Minority Shareholders Watchdog Group

Ms Christina Foo, MD, Priority One Consultancy Services Sdn Bhd and Vice President MIA

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