

ACCOUNTANCY FUTURES

Value regained: restoring the role of audit in society

A ROUND-TABLE DISCUSSION IN CARDIFF, 23 MARCH 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.

www.accaglobal.com/af

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

Ian Welch
Head of Policy, ACCA
ian.welch@accaglobal.com
tel: + 44 (0)20 7059 5729

Glenn Collins
Head of Advisory Services, ACCA UK
glenn.collins@accaglobal.com
tel: +44 (0)20 7059 5956

BACKGROUND

The event in Cardiff on 23 March was the third in a set of UK debates on the future role of audit, which in turn form part of a wider international series of round-table discussions, aimed at generating ideas and debate on the role of audit and devising recommendations to enhance the value of audit for all stakeholders. ACCA has recently published a policy paper setting out its views as a start to that debate.¹

ACCA believes that qualified auditors, whose training engenders qualities of professional scepticism and independence of thought, can add genuine value to businesses, and we are pleased that participants in the current series of round tables have attested to that value. These include stakeholders such as banks and ratings agencies, which means audited companies are in a better position to access finance and to have a good credit rating. While governments often equate the audit with 'red tape' and seek to win favour by freeing smaller businesses from a mandatory audit, there is often too little regard paid to the importance of independent assurance.

This is not to say the audit should not evolve. As set out in our paper, ACCA believes that, at the large end of the market, auditors could enhance the value of audit still further by giving an opinion on issues such as the assumptions underlying companies' business models. The effectiveness of their risk management and corporate governance processes could also be assessed. For smaller businesses, more appropriate segmentation of services could be provided, with new forms of assurance. There could be fewer checklists and more targeted focus on areas of agreed concern to the business.

But it is important that the profession makes its case for the value of audit. The need for this is particularly acute, given the global financial crisis, when questioning of finance professionals is understandably prevalent. The round tables are part of ACCA's contribution to that effort.

DISCUSSION

The issues discussed in Cardiff could be summarised as: (a) the need for greater communication and better disclosure and (b) the practical difficulties involved in achieving this.

The issue was raised of whether companies were reporting on the right things and hence whether auditors were verifying the sort of information needed by investors.

Different stakeholders have need different requirements but auditors felt that the two areas of real danger for them – in terms of possible litigation – included fraud and going concern. The fraud issue revolved around the ongoing expectations gap between the wider public perception of what an audit can do, and the professionals' knowledge of the inherent limitations of an audit to root out fraud. The persistent continuation of this gulf was bemusing to some, thinking back to their training of 20 years ago when the problem was still being debated. Until the liability question is satisfactorily resolved, it will be hard to resolve some of these issues.

For going concern, auditors find this a difficult area – who can be so definitive on what will happen in the future? There have already been acknowledged problems between the auditors and credit ratings agencies over this – the former accusing the latter of over-reacting to going concern notes and treating them the same as qualified audit reports. In some cases this has had serious consequences for SMEs' credit ratings and hence their ability to raise finance in a tough market.

1. http://www.accaglobal.com/pubs/general/activities/library/other_issues/other_pubs/2010/pol-pp-rva2.pdf

COMMUNICATION

The going concern controversy perfectly illustrates the need for careful communication and disclosure, particularly in a febrile market. Auditors say they are advising clients to be transparent and say more about the situation but many don't want to. Should they have to specify when their overdraft or banking covenant comes to an end?

Banks say they rely on auditors to tell them what is going on, with regards to Going Concern issues, but admit that such a report might lead them to pull the plug on a business. Panelists discussed whether it might be more appropriate for large companies with their public reporting obligations than for SMEs, which might be more vulnerable to a bank taking a hard line.

Participants asked whether the filing of delayed accounts on the public register many months after the year-end could be of much value, and once again wondered whether, in the case of SMEs, not facing the same requirements of getting information into the public domain, monthly management accounts prepared by an independent party would be of more use to stakeholders. Incidentally, this issue was also raised at ACCA's Ukraine audit in society event where it was suggested that the monthly reports should be made publicly available, with an onus on the audit profession to devise a way of verifying those reports. There was an acknowledgement though that in recent years the gap after the year-end had come down sharply and was often now nearer 3 or 4 months rather than 9. The role of audit committees was seen as important but the experience level of those on the committee was crucial in dealing with auditors concerns.

EVOLUTION

Participants supported the value of audit but wanted it to evolve. They highlighted the need to report on current financial and non-financial information, which was considered a natural evolution for reporting. They also felt that financial reporting and audit reports had to be considered together and that development of both was required. But do the accounts cover everything needed by stakeholders? There was a view that lots of useful information is not included in the financial statements or is not easily accessible to anyone who is not an accountant. Notably the focus on performance, it was argued, can result in a distorted view. Often the key risks and performance measures are hidden in the accounts. These are important to the future well-being of the entity and yet many readers would not spot them.

And is there adequate disclosure in accounts generally? – users want more information, while some entities try to give the minimum. There seems to be a lack of understanding on when extra information is provided in the accounts by the directors and also the inclusion or non inclusion of a fundamental uncertainty para in the auditors report. This point was further expanded, with comments that the language of the audit report could be improved. All this suggests a lack of agreement on what should be communicated to stakeholders.

But should the role of the audit change? While the value of audit had been agreed by the participants, some argued that there was no longer sufficient dialogue between auditors and regulators. This was seen as an issue especially for the Welsh Assembly and wider government sector. In other ACCA round tables, the lack of a general protocol under which auditors report risk concerns to regulators has been noted as a problem. It does seem that the relationship between auditors and regulators needs to be addressed by the authorities.

Some of the ideas put forward in ACCA's audit policy paper also generated comment.

Participants debated whether extending the mandate of auditors to question the sustainability of the assumptions underlying the business model would challenge the auditors' skill sets. Some wanted more detail on what was included, such as debtor days. But there was agreement that examination of such issues, plus risk and governance would be useful. And by including in the audit report some of the information currently kept in the letter to management, it was felt that some of the problems of communication might be overcome. But some entities would always be wary of disclosing what they deemed sensitive information.

PUBLIC SECTOR

The public sector was the focus of a separate discussion. ACCA has praised the wider role of audit firms when auditing clients in this sector in our paper and participants said it was crucial that auditors did a good job as many non-accountants in the government sector will receive their reports and largely assume things are correct – they would not have skills to challenge them. There was an issue of who received both internal and external auditors' reports. The fact an independent auditor had undertaken a review was sufficient for some which mean it was vital that auditors' work should be accessible and understandable for users.

The issue of auditing very different outcomes in the public and not for profit sectors came up – how would it be possible to successfully account for, and audit, the success of a social worker, in solving problems of troubled families for example? The more innovative approach used in the public sector was noted by participants, especially in its use of experts. This was seen as a model that the private sector auditor of the future may be required to follow – especially if the role of the audit is to expand into other areas as ACCA suggests. It would be impossible for any single auditor to have all the skills – it will require knowing when to bring in those who do. Business risk, performance and strategy all needs to be looked at. Auditors will be required to use their audit skills and assess the outcome against the specific required outcome from the key risk area.

But the extra skills that auditors of the future may face being part of their training should not faze them. Former auditors on the panel confirmed ACCA's core belief that audit skills should form part of every accountant's pre-qualification training because 'it stays with you'. The independence and professional scepticism engendered allow the auditor to question the feel good messages coming from other parts of the business and give him the strength to say no.

The fact that in the public sector particularly, internal and external auditors were so often recruited by other parts of the business or other entities showed the value of their training. This was a fitting note on which to end the debate on the value of audit. ACCA found the event very useful in exploring both the opportunities and the limitations for expanding the role of audit. The issues of limiting liability for auditors, increasing communication between auditors and audit committees and quality of disclosure needed by investors will be taken forward in our ongoing debates.

THE PARTICIPANTS

- Arwel Thomas, Head of Corporate Governance and Assurance, Welsh Assembly Government
- Gareth Lynn, Director, KTS Owens Thomas
- Markus Matthews, Area Director, NatWest
- Ray Hurcombe, Chief Executive, Ty Hafan
- Adrian Hamilton, Finance Director, Atradius
- Glenn Collins, Ben Cottam, Steve Priddy, Ian Welch, ACCA

POL-AF-VALCAR