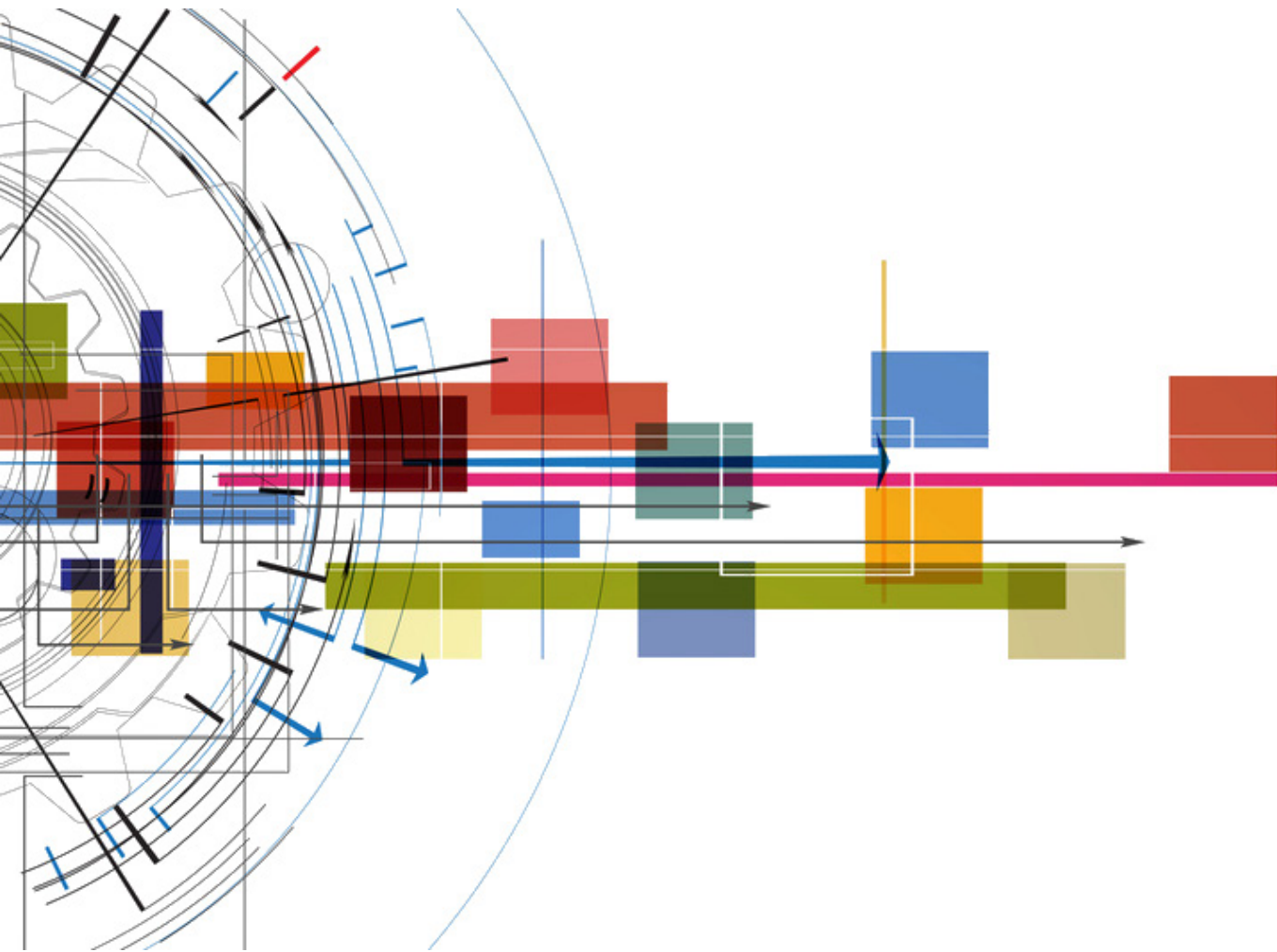




Federation of European Accountants

IDEAS



Pursuing a strategic debate

The future of audit and assurance

DISCUSSION PAPER

HIGHLIGHTS

The FEE discussion paper *Pursuing a strategic debate* follows up on *Opening a discussion: the future of audit and assurance* from 2014. It is based on the responses received to the 2014 paper and on the debate at the FEE audit conference *Long Term Vision and Short Term Challenges* in June 2015.

FEE's work aims to keep the accountancy profession engaged in an open and dynamic debate with its stakeholders and propose changes to respond to a rapidly changing environment. This paper thus identifies three main topics for the future of audit and assurance:

- respond to stakeholders' needs
- encourage innovation driven by technology
- rethink education to ensure the right skillset for the future

The challenges that lie ahead for the profession go along with plenty of opportunities to further evolve and better serve new markets' needs. FEE is committed to support the constant adaptation of the profession, while continuously promoting the fundamental principles of integrity, objectivity and independence, professionalism, competence, and confidentiality.

Responding to stakeholders' needs

Identifying stakeholders' needs to make the model evolve

“One size fits all audit may not be appropriate for all types of companies anymore due to the very differing needs that risk equity investors may have. For example, many public company investors believe that an audit should give some sort of assurance over [Key Performance Indicators] KPIs or risks that are disclosed. However, this assurance is clearly not needed for owner-managed private companies whose shareholders will have a good understanding of the business. As such, the assurance model needs to evolve to meet differing needs. Then, the profession will need to demonstrate what can be done and how the range of assurance products can meet the needs and expectations of the different stakeholders.”

A respondent of the discussion paper

“The new audit report enhances the credibility of the financial statements. Why now? It enhances the communicative value of it, increases the attention of management [...], and helps us, users, to benefit from those efforts.”

Hans Buysse

Engaging with stakeholders was recognised as being at the heart of the discussion on the future of audit and assurance. There was consensus that the focus of the profession's engagement with stakeholders was sometimes unduly limited to regulators and that this focus should not be to the detriment of other stakeholders. The audit was historically performed to serve the shareholders. With enhanced public auditor reporting, it should be more and more about serving investors and ultimately the public at large.

Respondents acknowledged that listening to investors was key. To better engage with investors and respond to their expectations, as suggested by some respondents, the audit remit and operating model would need to evolve.

With the evolution of society and technology, the way money is invested is evolving, crowdfunding being a typical example. Auditors will have a role to play in providing comfort to those new investors. The European Commission's Capital Markets Union initiative will also open new investment avenues, and hopefully enhance SMEs' access to finance.

Committed to continue enhancing public trust

The developments in auditor communication provide the auditor with an opportunity to be more open with stakeholders on the work performed, the judgements taken, and the reasoning behind conclusions reached, thereby enhancing public trust.

Auditors have a role to play in increasing transparency and in helping combat corruption. Analysing public data, for instance via social media listening tools², could make this happen. Social media listening, also known as social media monitoring, is the process of identifying and assessing what is being said about a company or a brand on the internet. In general, it was emphasised at the FEE audit conference that radical changes are taking place in society concerning the quantity, availability, and accessibility of data.

Open communication would also enable the profession to inform public opinion on the usefulness and relevance of audit and assurance services which should not be regarded just as a bureaucratic and compliance burden for companies. At the moment, some stakeholders regrettably regard audit as merely a compliance service.

Continuous and structured dialogue with regulators and the public can help the accountancy profession address issues relating to the credibility and

² Reference to the contributions of Mona de Boer - Senior Manager, PwC during the FEE audit conference

performance of the audit work. Some of the responses received brought to the forefront existing examples of good communication practice such as the transparency report as required by the EU audit regulation. These transparency reports are increasingly useful in helping stakeholders assess the quality of a particular firm. Other examples such as *Audit Firm Governance Codes*³, which have been implemented, for instance, in the UK and the Netherlands, were also mentioned.

Integrity and objectivity are recognised as the key pillars of the profession. The need to demonstrate both of these undoubtedly increases when public trust is eroded.

For large undertakings: developing new services to respond to changing needs

Changes in technology lead to increased access to, and interest in, corporate affairs. In the FEE publication on the *Future of Corporate Reporting*⁴, the idea was put forth that the audience for corporate reporting is growing. As such, the needs of this growing audience, both from a corporate reporting as well as an assurance perspective, would need to be addressed.

Respondents considered financial information to be at the heart of the profession. Nevertheless, a large number of respondents thought that the profession needed to respond to the recent developments in narrative and non-financial reporting. Given the increasing importance that businesses give to non-financial drivers and *Key Performance Indicators* (KPIs), the profession should strive to address these market needs. Market demand for assurance is also expected to rise as a result of mandatory disclosures of non-financial information for large undertakings.

It was clear from some respondents that users of corporate reports might expect increased transparency on the future viability of the entity. This could lead to the current going concern basis of accounting with its twelve-month horizon not being fit for purpose in the future. Management and/or those charged with governance might be expected to be more vocal about their underlying assumptions on the going concern of the entity along with their forward-looking business expectations, and the auditor might be asked to provide assurance over these assumptions. This is already the case in a few jurisdictions, for instance in Austria and Germany.

On being asked to identify areas where the auditor's involvement could add value, some respondents suggested that auditors should expand their work to cover entity- or sector-specific topics, if it could be demonstrated as adding value to investors or other key stakeholders. Among the

“ We are very clear at Transparency International about what statutory audit means. It provides assurance that the companies are in compliance with a narrow set of accounting conventions, and does not signify financial health, a corruption free zone, or anything that the public, NGOs, or even the courts might think is socially desirable. We need to seriously think through of what the social responsibilities of the auditors are within these constraints.[...] The role of the auditor therefore, in helping increase transparency to help combat corruption, is more in focus today than ever before, and in an environment that is more challenging than it has ever been.”

Carl Dolan

“ To build trust, we need the values that I read about on the FEE website: the values of integrity, objectivity, independence, professionalism, competence and confidentiality. To which I might add that auditors need a good dose of scepticism and courage: they need to be prepared to speak truth unto power. These are qualities which need to come from within the profession, attitudes of mind, standards of conduct which reflect a determination to do the right thing, not simply to comply with a legal requirement.”

Lord Jonathan Hill

³ The Audit Firm Governance Code imposes requirements to audit firms on internal supervision, reporting and stakeholder dialogue.

⁴ More information at <http://www.fee.be/library/list/50-corporate-reporting/1529-1510future-corp-rep.html>

Table 1 – Potential other services to be developed further

Assurance on forward-looking information	Assurance on non-financial information	Compliance assurance services	Enhanced business reviews
Assurance on prospective and more forward looking information - liquidity forecast - cash-flow forecast - profit forecast - going concern	Assurance on non-financial information, narrative and KPIs within annual reports and corporate responsibility reports. Assurance on integrated reporting <IR>	Assurance services relating to compliance on - IT systems - cybersecurity - internal controls - risk and risk management - prudential reporting - corporate governance	Enhanced business reviews providing insights into the quality and operating effectiveness of the entity's management, including benchmarking against peers and industry leaders.

respondents who support the idea of developing new services, these services can be broadly categorised as in Table 1 above.

Supporting Small and Medium-Sized Entities (SMEs)

“Increasingly, the profession needs to promote itself and its services. This will involve: being more transparent as to what an audit involves, considering supplementary assurance services and, for those entities not subject to statutory audit, alternative assurance and related services to meet their individual needs.”

A respondent to the discussion paper

SMEs represent an area of intense interest, being the backbone of the European economy. The audit is still seen as a value-added service for SMEs. Consensus was reached among respondents that there were a number of alternative service offerings besides statutory audits which the accountancy profession could use to meet the current and future needs of SMEs.

Different users of SME financial statements have different needs, as summarised in Table 2 below.

There were differing opinions as to whether new assurance services should be developed or whether we should focus on the current assurance offerings. As mentioned above, there are indeed a lot of alternatives in the range of services provided, but are they still fit for purpose? There is a need to remain agile and adaptable when performing audits for, and delivering other services to, SMEs. Some respondents believed that rather than develop a new range of services, the profession should instead promote its

Table 2 – Users of SME financial statements and the related needs

Needs	Users
Reliability of financial information reported	Shareholders, investors Banks, lenders Tax authorities
More confidence on going concern	Customers, suppliers, employees, trade unions Banks, lenders, tax authorities
Appropriate disclosures	Shareholders, investors, Banks, lenders Tax authorities
Risk coverage	Banks, lenders

work and better inform interested stakeholders as to the various service offerings that already exist.

It was clear from the responses received that the use of standards makes users more confident in the product, and that high quality standards are the cornerstone of the framework that has bolstered confidence in financial reporting and auditing. It was widely recognised by the respondents that, to be effective, standards need to be applied by well-trained teams capable of exercising professional judgement. Standards should be developed in a way that facilitates proportionate application for the audit of the smallest entities, and should be reviewed periodically to ensure they remain fit-for-purpose and are adapted for technological developments.

Supporting Public-sector entities

There was consensus amongst respondents that management of public finances should be a key priority for the profession, although drivers for improvement vary from country to country, as does the level of advancement in public sector accounting. The profession could be called upon to offer various forms of assistance in this regard. For example, external auditors can make a significant contribution by drawing management's attention to weaknesses, such as deficiencies in accounting systems and internal control over financial data and reporting. Developments in financial reporting that are currently being discussed within the EU may bring a need for further support in some EU member states, including staff training. The profession can also be drawn upon to provide assistance in the fields of accounting and auditing when entities are faced with staff shortages.

The contribution of the audit profession – working either in the public or private sector – to help enhance the quality financial reporting in the public sector could be through:

- promoting and facilitating the broad adoption of accrual accounting in the public sector
- issuing guidance on how to best address new regulatory developments in the public sector
- providing input in the development of public sector reporting standards⁵
- performing financial audits of public sector entities⁶
- undertaking other assurance engagements, such as compliance audits, performance audits, etc.

“The range of alternatives to be provided will depend upon the parties relying 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, even if not mandatory. Before considering the range of alternatives to statutory audit, we need to consider what information these user groups actually seek comfort over.”

A respondent to the discussion paper

⁵ See also: http://www.fee.be/images/BP_141016_-_EPSAS.pdf

⁶ See also: http://www.fee.be/images/publications/Information_paper_performance_audit_in_the_public_sector.pdf

Encouraging Innovation Driven by Technology

“History has demonstrated that we cannot prevent innovation from happening, even not through laws, regulations or any other means.”

Christoph Hütten

“The speed of change is not linear anymore, it is exponential. The pace of technology change drives the business: it drives how things get done, how companies evolve and how they will survive. We have to acknowledge that most businesses have the potential to become a technology business. Look at what has happened to the bookstore industry, to the car or transportation industry, to the hotel industry. The impact on the audit industry needs to be considered: if our industry changes in a linear fashion in this exponential change environment, there is a risk to be left behind.”

Ashton Dallsingh

“Just imagine an audit that would be fully automatized with a certification system. One thing that technology will not take over is judgement.”

Christoph Hütten

It was acknowledged by respondents that IT innovation is profoundly affecting all industries and sectors; the pace of development is rapid and the audit profession needs to adapt in the same way as any other business and profession.

Technology is affecting the audit profession both externally, through the technology used by clients, and internally, through the technology used by the auditor. Technology could be seen as something helping to address business challenges and/or as a business challenge itself.

All agreed that the core concept of an audit of financial statements would remain the same – obtaining sufficient appropriate evidence over the completeness, existence, accuracy, valuation, timing, and classification of material matters. Nevertheless, given developments like continuous auditing, this still remains to be seen. Technology plays a key role in continuous audit activities by helping to automate the identification of exceptions or anomalies, review trends, or test controls. Although the manner in which the evidence might be obtained and the risks to be addressed will change, professional judgement and scepticism will remain the bedrock of an audit.

Any change in process will bring risks that need to be managed. New business techniques will also require new skills. Audit firms are widely investing in IT to maximise quality, efficiency and effectiveness in order to leverage the relevance and usefulness of the audit in this changing environment. Process mining was an example that was put forth at the FEE audit conference demonstrating how auditors might make use of big data⁷. Further considerations need to be addressed, such as the impact on audit methodology, the reliability and protection of the data and the level of evidence.

Professional bodies, firms and other bodies involved need to make sure that the way we educate and train future auditors, which will include their continuous professional development, is still fit for purpose. This will ensure smaller firms keep up with the pace of change.

As emphasised by many respondents, and at the FEE audit conference, technology should not override the human factor; physical presence is still important to fully understand a client’s business and its processes and to remain fully relevant. The profession should be careful not to head towards ‘virtual audits’.

⁷ Reference to the contributions of Angelique Koopman - Partner, Coney and PhD Researcher, Tilburg University during the FEE audit conference

The word cloud below is the very clear response of the conference participants to the question: “What do you see as the key skills for the auditor of the future?”



“ Stand up, stand out, make your voice heard, go and debate publicly, be visible in society, show people what this profession can be to everybody. Public interest it is called, but it is simpler than that. You can be so powerful and helpful to society but they have to see it, they have to experience it. So don't lock yourself behind any door.”

Arnold Schilder

A need to rethink education to ensure the right skillset for the future

According to the responses received to the discussion paper, even though IT skills are deemed to be important, ethics together with the ability to exercise professional scepticism in making sound professional judgements will still be important elements of the skillset in the future. Understanding the business environment in which clients operate will also remain paramount.

Depending on how the range of services provided will evolve, the education and training requirements of auditors and other assurance providers may vary greatly. The types of people being attracted to the profession might also change. It could be argued that besides the necessary competence in technical areas, more generally, professional accountants and auditors need to be educated on: behavioural matters that promote ethical behaviours (integrity, objectivity, and professional behaviour); better communications, in particular listening skills; better 'people' skills; and enhanced critical thinking and reasoning, perhaps even being founded in some form of basic psychology. These points are outlined in Table 3 on the following page.

It was acknowledged by respondents that we need to maintain the highest quality of education of new auditors, and the idea of promoting more consistent, global education standards was put forth. The knowledge and ability to adapt required of auditors and assurance providers in an increasingly complex business environment are changing.

In this dynamic environment, it was highlighted by respondents that the profession would need to adapt its training curriculum, and recruitment model, to include more individuals from non-accounting backgrounds to develop multi-disciplinary teams.

“ Both generalists and specialists are more and more needed to form multidisciplinary teams specialised in either a specific industry, in IT, or in actuarial services. It is therefore important to open the profession to engineers and other specialised profiles with for instance expertise in the banking, nuclear or medical industry.”

A respondent to the discussion paper

Table 3 - Auditor skillset needed as emphasised by respondents to the discussion paper

Auditor skillset
Ethics and values Professional behaviour, including independence Professional judgement and scepticism
Ability to understand the business environment and related business risks Risk management Different types of risks and areas of expertise
Business skills
Soft skills, such as leadership, problem-solving attitude, management, communication Ability to understand the behavioural characteristics of an organisation/directors
Technical skills and knowledge on accounting, auditing, mathematics, statistics Analytical skills and critical thinking IT knowledge and skills

“ I am happy to see that you have taken the opportunity of the FEE conference to contribute to developing a vision for the future. Working together, listening to all stakeholders are the only way for the profession to keep providing relevant, high quality and reliable services and contribute to strong and sustainable global economies.”

Olivier Boutellis-Taft

Conclusion

Many challenges lie ahead for the audit profession, but so do plenty of opportunities to further evolve and better serve new markets’ needs. FEE is committed to supporting constant adaptation of the profession to an ever rapidly changing environment, while continuously promoting the fundamental principles of integrity, objectivity, independence, professionalism, competence and confidentiality that make our profession stand out.

Our charter to society of seeking to uphold the public interest remains embedded in our day to day activities. Ultimately, we all have the same end game: improving quality in both corporate reporting and assurance to make the products we provide to the market place the best that we can possibly achieve.

Appendix

Quotes from the speakers of the FEE audit conference on 22 -23 June 2015 (in order of appearance in the publication)

Alan Johnson, Non-Executive Director, Jerónimo Martins SGPS, S.A

James Doty, Chairman, PCAOB

Hans Buysse, Vice-Chairman of the Belgian Association of Financial Analysts

Carl Dolan, Director, Transparency International EU

Lord Jonathan Hill, EU Commissioner Financial Stability, Financial Services and Capital Markets Union

Christoph Hütten, Senior Vice-President and Chief Accounting Officer, SAP SE

Ashton Dallsingh, Vice president and CFO EMEAR, Cisco System Ltd

Prof. Arnold Schilder, Chairman, IAASB

Olivier Boutellis-Taft, Chief Executive, FEE

List of respondents to the FEE discussion paper

Individuals: 3

Firms: 7 that include BDO LLP, Crowe Horwath International, Deloitte, Grant Thornton International Ltd, KPMG, MAZARS and PwC

Other stakeholders: 5 that include ASSIREVI, AMA, CDBAA, ECIIA and IIA

FEE Members: 11 that include CACR, CAFR, CNCC, ICAEW, ICAS, ICJCE, IDW, IRE-IBR, NBA, SOEL and TURMOB

International and European organisations representing the profession: 3 including IFAC, ICAA and EGIAN

Some responded to all the questions included in the paper, others provided FEE with a cover letter raising the main considerations.

Debate was also fostered by FEE via participation in other stakeholders' conferences and discussions with the FEE Members' Assembly and diverse FEE working groups.

Table 4 - Programme and Speakers of the FEE Audit Conference, June 2015, Long Term Vision and Short Term Challenges

Monday 22 June 2015	Tuesday 23 June 2015
<p>Session on: what stakeholders expect from auditors</p> <ul style="list-style-type: none"> - Eric Anstee - Executive Chairman, CPP Group Plc and Independent Non-Executive Director, PayPoint Plc. - Carl Dolan - Director, Transparency International EU - Janine Van Diggelen - Chair, IFIAR - Luc Vansteenkiste - Chairman, European Issuers <p>Keynote address: transatlantic regulator perspectives</p> <ul style="list-style-type: none"> - James Doty - Chairman, PCAOB <p>Session on technology: how business is reshaping and how the firms are adapting</p> <ul style="list-style-type: none"> - Ashton Dallsingh- Vice president and CFO EMEAR, Cisco System Ltd. - Christoph Hütten - Senior Vice-President and Chief Accounting Officer, SAP SE - Mona de Boer - Senior Manager, PwC - Angelique Koopman - Partner, Coney and PhD Researcher, Tilburg University - Nicholas Frost - Partner, KPMG <p>Keynote address: auditor skillset and what has to change for the future</p> <ul style="list-style-type: none"> - Graham Durgan - Chairman, Emile Woolf International 	<p>Session on audit quality: a core element to the future of audit</p> <ul style="list-style-type: none"> - Prof. Arnold Schilder - Chairman, IAASB - Carlos Tavares - Chairman, Portuguese Securities Market Commission and Vice-Chairman, ESMA - Alan Johnson - Non-Executive Director, Jerónimo Martins SGPS, S.A - Harald Kayser - Partner, PwC <p>FEE ongoing project on the Future of Audit and Assurance</p> <ul style="list-style-type: none"> - Myles Thompson - Chairman, FEE Audit and Assurance Policy Group <p>Session on auditor communication: enhancing the value of audit</p> <ul style="list-style-type: none"> - Jimmy Daboo - Audit Partner, KPMG - Philippe Castagnac - CEO and Chairman of the Executive Board, Mazars Group - Hans Buysse - Vice-Chairman of the Belgian Association of Financial Analysts <p>Keynote address: contribution of the audit to the capital markets union</p> <ul style="list-style-type: none"> - Lord Jonathan Hill - EU Commissioner Financial Stability, Financial Services and Capital Markets Union <p>Session on the audit reform implementation</p> <ul style="list-style-type: none"> - Stephen Haddrill - CEO, UK Financial Reporting Council - Kai-Uwe Marten - Deputy Chairman, Auditor Oversight Commission (APAK), Germany - Christian Schricke - Managing Director, Association Nationale des Sociétés par Actions (ANSA), France - Alain Deckers - Head of Unit, European Commission Audit and Credit Rating Agencies

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Federation of European Accountants

WHO WE ARE

FEE represents 50 professional institutes of accountants and auditors from 37 European countries, with a combined membership of over 875,000 professional accountants working in different capacities. As the voice of the European profession, FEE recognises the public interest.

FEE is in the EU Transparency Register (No 4713568401-18).