



## Breakfast Debate:

# Is positive assurance on narrative reporting the way forward to meet stakeholders' needs?

Thursday 26 September 2013, Silken Berlaymont Hotel, Brussels

## SUMMARY OF DISCUSSIONS

In April 2013, ICAS issued a discussion paper entitled: *Balanced and Reasonable: A discussion paper on the provision of positive assurance on management commentary*, to initiate and stimulate a debate over the future of assurance. As part of a series of events, ICAS organised this breakfast event, in conjunction with FEE, to facilitate a debate with an international audience. A distinguished panel assembled in the Silken Berlaymont Hotel in Brussels on 26 September, in front of 40 guests, to debate the key issues:

### Key issues highlighted in the ICAS paper:

*Is it possible for auditors to provide a positive opinion on narrative reporting, namely the front-half of the annual report?*

*Do you believe that the benefits of providing such assurance would outweigh the additional costs?*

*Do you believe that there is increasing investor demand for the provision of positive assurance over the front-half of the annual report?*

*Would the current IAASB assurance framework need to be revised to make the provision of such an opinion possible?*

The CEO of FEE, in his introduction, referred to methods applied by car manufacturers developing a concept for a new car design. Some of the most successful manufacturers were those who included users/consumers in their design groups. There was a message for auditors - listen to the user groups and investors and produce the type of report they want.

The moderator for the event introduced the 'Balanced and Reasonable' discussion paper as the next stage in improving the assurance process highlighting that:

1. In Denmark, auditors had in the past audited the management commentary.
2. In Germany, there was a requirement for the auditor to provide a positive opinion on certain aspects of the front- half of the annual report.

### Question 1: Is it possible for auditors to provide a positive opinion on narrative reporting, namely the front-half of the annual report?

The ICAS representative gave some background on the purpose of the paper, issued to highlight what ICAS considered key issues on the provision of positive assurance on the front-half of an annual report. The ICAS response to the recent financial crisis had been the issue of the *Future of Assurance* paper. One of the recommendations from this paper was that management should include a statement that the narrative content of the annual report was 'balanced and reasonable' and that auditors should provide a positive opinion on this statement. The key driver for the

additional assurance was user demand. Research undertaken by ICAS and others suggested that there was a demand.

The paper defined the terms 'balanced' and 'reasonable' and how they might be applied. More judgement would be required in order to provide this type of assurance. The concept of 'balanced and reasonable' established the criteria against which an auditor's opinion could be expressed.

ICAS considered that the current IAASB framework may need to be revisited. Could the same level of assurance be provided over the front-half of the annual report, which relied more on the auditor's judgements, than evidence?

The FRC in the UK had adopted "fair, balanced and understandable" as its terminology but had not gone as far as ICAS would like. ICAS recognised that assurance on integrated reports would be required to ensure their credibility and hoped that its paper may assist in the development of a framework for such assurance.

**Question 2: Do you believe that the benefits of providing such assurance would outweigh the additional costs?**

The UK panellist advised that the costs v benefits exercise would depend on the approach. If a high level of assurance was provided, the additional costs should reflect the extent of work undertaken.

Referring back to the car manufacturer analogy, the most successful cars were those where input had been sought from both producers and consumers. Dialogue between preparers and users therefore was vital. Currently there were significant elements of an organisation's business model not subject to any assurance so auditors were only addressing half of the story. But they needed a mandate from investors and other stakeholders as to their desire for more.

Our profession had to evolve to meet the needs of users and the public interest and understand the benefits of doing so and discuss and highlight the benefits of work of this nature with the investors. It was important that we communicated what we were capable of doing and what we could not do. Finally, the word audit originated from the word to listen! Accountants needed to be more of a listening profession.

An academic from Belgium voiced his fear that the negative perception in relation to the financial statements' audit might be extended to the narrative content so we would not be able to justify the additional costs as the information provided would not reflect what people wanted to know.

**Question 3: Do you believe that there is increasing investor demand for the provision of positive assurance over the front-half of the annual report? (with an insight into the German experience).**

The German panellist commented that, in Germany, auditors currently provided assurance over the management reports. A new standard had been issued on the group management report, GAS 20, providing guidance on how it could be audited and established suitable criteria as prescribed in the IAASB framework.

There was demand amongst German investors for positive assurance on the management report due to the limitations of the historical information provided in the financial statements. They expected more than just a quick 'read and consider' or consistency check, which in many instances, took place at the end of the audit.

The ICAS suggestion of a new 'medium' level of assurance was thought-provoking. If the information was not appropriate per the IAASB criteria for reasonable assurance, then an assurance engagement should not be undertaken. However, there were no criteria for determining what was considered 'fair, balanced and understandable', which was now a requirement for UK auditors.

A Belgian delegate observed that Integrated Reporting may result in a need to bring this together. If there was a need for assurance from stakeholders then let them define the need. We would not resort to boilerplate reporting but rather include special paragraphs from the auditor in relation to the annual report.

In France, the management report was required to disclose all risks but rarely did. If the auditor only performed a consistency check, what was his/her locus if a non-financial risk was omitted?

**Question 4: Would the current IAASB assurance framework need to be revised to make the provision of such an opinion possible?**

The ICAEW representative reiterated that an assurance engagement required a subject matter and suitable criteria per the assurance framework. The criteria should be assessed as a basis for expressing assurance according to: Relevance; Completeness; Reliability; Neutrality and Understandability.

Two types of assurance engagement were recognised: limited assurance and reasonable assurance. The difference between the two was hard to define and based on the practitioner's judgement.

Are 'balanced and reasonable' suitable criteria? Do they fit within the 5 criteria above? Or should the IAASB framework be revisited as the ICAS paper suggests?

The International Framework for Assurance Engagements stated that: 'The evaluation or measurement of a subject matter on the basis of the practitioner's own expectations, judgments and individual experience would not constitute suitable criteria.' So did the ICAS 'Balanced & Reasonable' approach fall within this definition or did it need to be revised for to fit into the current framework? Users wanted a positive opinion but under the existing framework can we get there? Can the profession find a solution? In the UK there was a requirement for annual reports to be fair, balanced and understandable. This was also not probably within the IFAC framework. But, we can make it work.

**Positive assurance on narrative reporting – a Danish perspective**

The Danish speaker opened his presentation with the statement that the negative (limited assurance) opinion is the biggest self-inflicted problem for the profession. In Denmark, until 2009, an audit was undertaken on the management review and a true and fair opinion was issued. Following the issue of the clarified ISAs in 2010, it was not possible for the Danish profession to provide a positive statement in the management review as it fell outside the IAASB assurance framework.

In relation to the 'balanced and reasonable' proposal, reasonable assurance would not be possible for non-financial and forward-looking information so only a lower level of assurance could be provided.

In conclusion, the conundrum was compared to that of the bumble bee – which theoretically should not be able to fly because of its wing size in relation to its body – yet it finds a way.

**Conclusion**

So have the Germans found a solution to ensure that the opinion fits within the assurance framework? Can you give positive assurance on assumptions? There is a challenge for all in the profession – surely we should not just follow the legislators, we should actually lead the way.

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