

FEE

Federation of European Accountants – Fédération des Experts comptables Européens
Avenue d'Auderghem 22-28/8
B-1040 Brussels
secretariat@fee.be

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Dear Sirs,

Response to the FEE discussion paper on 'The Future of Audit and Assurance'

We are pleased to respond on behalf of the European Union member firms of Deloitte Touche Tohmatsu Limited¹ to the FEE discussion paper on 'The Future of Audit and Assurance' (the "Discussion Paper").

We commend FEE for issuing the Discussion Paper on this important topic which is a corollary of the wider debate on corporate reporting on financial and non-financial matters. Taking a medium and long-term perspective, we support a holistic, forward-looking and strategy oriented corporate reporting that will help provide users with a longer-term and broader perspective complementing the financial statements². This reporting should be driven by users' legitimate and reasonable needs, and independent third party assurance on this reporting also needs to be examined, taking into consideration the costs and benefits of both reporting and assurance.

Questions related to the objectives of opening this discussion

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

To effectively respond to expectations in a constructive and realistic manner, we need to ask fundamental questions about the value and purpose of the audit and assurance more broadly and for whom they are being provided. This in turn depends on an understanding of the different stakeholders' reasonable needs and expectations for financial and other reporting, recognising that audit and assurance are about improving users' confidence in reporting by preparers. It is right that the profession

¹ Please see <http://www.deloitte.com/about> for a description of the legal structure of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its member firms.

² Please see 'Unlocking investment in infrastructure', B20 Panel of six international accounting networks, June 2014, p.6, <http://www.iasplus.com/en-gb/publications/miscellaneous/b20-report>.

should consider both the shorter term perspective of the next five years and also the medium to longer term perspective of the next ten to fifteen years.

Currently audits are mainly focused on the past and on issuing standardised opinions and reports on financial and some limited other information prepared by management. Based on recent research, stakeholders believe that receiving greater insight from the auditor on the audited company's performance and the risks it faces would be valuable³. These findings could be usefully further tested with stakeholders, including other groups of stakeholders who were not considered as part of this research, and be developed.

In the shorter term, enhanced auditor reporting under the new EU audit legislation and relevant new or proposed standards will help to increase stakeholders' understanding of the audit, the audited entity's internal controls and the risks facing it, at least as far as they affect the financial statements. Early investor feedback on the UK's enhanced auditor reporting regime, introduced for financial years ending on or after 30 September 2013, shows increased appreciation of the value of the audit; likewise, efforts for early adoption on a voluntary basis of the IAASB's proposals in the Netherlands have been appreciated.

Without wishing to make the assumption that a financial statement audit will necessarily provide insight into non-financial disclosures in all circumstances, increased management/board reporting on non-financial disclosures under the new EU accounting legislation and the auditor's role⁴ regarding those disclosures should in any event show the value of both more extensive corporate reporting and assurance on that reporting. This could in turn lead to further disclosures and auditor assurance on these disclosures such as, for example, providing a level of assurance on relevant key performance indicator disclosures provided by the audited entity⁵ or on risk disclosures.

In the medium to longer term, there may be scope and stakeholder appetite for different auditor reporting that could focus on value creation by the audited entity and on its business model, possibly including benchmarking with other entities, and perhaps ultimately not be limited to reporting on management's reporting. The costs and benefits of such further disclosures and assurance need to be examined, as well as the balance between market-led evolutions, which would encourage innovation and show where real needs lie, and a legislative approach which would favour consistency and comparability between different undertakings' reporting.

Stakeholders include company shareholders and potential investors, employees and trade unions, audit committee members, management of the reporting companies, regulators (market, prudential, audit), creditors of the reporting company, including banks and entities entering into contracts with the

³ 'Future role of audit – a more insightful audit for a more complex world', Forbes Insights, http://www.forbes.com/forbesinsights/future_role_of_audit/index.html

⁴ I.e. expressing an opinion on the consistency of this information with the financial statements and stating whether he or she has identified any material misstatements in the management report, in the light of the knowledge and understanding of the entity and its environment obtained through the course of the audit.

⁵ 'Future prospects', J. Ward, Audit & Beyond, <http://www.icaew.com/~media/Files/Technical/Audit-and-assurance/audit-and-beyond/audit-and-beyond-2014/auditbeyond-may-2014-future-proof.pdf>

reporting entity. The audit profession should examine how to best communicate with these different stakeholders, to achieve a fair and balanced response to their needs.

In addition to taking into consideration the costs and benefits of responding further to stakeholders needs, the different legal frameworks would need to be assessed against these needs, including addressing the following points:

- towards whom would the auditor have duties and responsibilities;
- the rules that govern this role (for example, direct communication with shareholders at the Shareholders Meeting or otherwise);
- a safe harbour regime in specific circumstances;
- requirements to respect the audited entity's confidential business information and data;
- the auditor's duty to respect professional confidentiality;
- data privacy issues and
- the rules governing the audit itself (standards, regulator guidelines).

These legal frameworks need to be fit for purpose for more extensive auditor reporting given the technological means of communication that exist and in order to strike the right balance between stakeholders' legitimate need for information, the audited entity's rights and obligations and the auditor's responsibilities.

2. How should the profession engage with stakeholders?

We commend FEE for having issued the Discussion Paper to start a debate. Many stakeholders will unfortunately not have the time and resources to reply fully to the Discussion Paper. We would suggest that FEE engage directly with stakeholders, including policy-makers, regulators and academics through a wide variety of means, such as forums and meetings, including online, electronic polling or short questionnaires. In particular, we believe that FEE should be actively engaging with European and international auditor oversight bodies, given their key role in monitoring, regulating and generally influencing and shaping the profession.

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?

Both audit and assurance standards add value by creating frameworks under which auditors can provide audit and assurance services. While standards do provide a consistent framework, some stakeholders view them as limiting innovation because they may be interpreted very narrowly, and may be seen as the only approach to be taken to provide any service – and can therefore stifle innovation or be applied inappropriately. As the scope of audit and assurance broadens, standards should remain principles-based to enable their application to a wide range of subject matters.

The ISAE 3000 standard and its supporting standards (e.g. ISAE 3410 on greenhouse gases emissions assurance) are assisting auditors to provide assurance in non-traditional areas, thereby supporting innovation. ISAE 3000, in particular, provides a broad, principles-based approach which can be flexed by assurance providers to accommodate a wide range of subject matters. In our view, it is important not to develop detailed rules-based subject-specific standards as this may otherwise stifle innovation. Development of such detailed standards too early in the process, for example before harmonisation of reporting practices, runs the risk of reaching a low common denominator by attempting to cater for countries with assurance policies and practices at different stages of maturity or by obtaining a consensus among too many different constituents. Equally, in developing reporting standards for preparers of information there is a balance to be struck between prescription (and hence standardisation) and innovation.

The international standard setting process is not responsive to immediate needs and there is a lack of response to changing forms of reports; it takes too long for standards to be developed, resulting in different jurisdictions “jumping the gun”, i.e. introducing new requirements without waiting for an international response. For example, we believe that as part of the move towards assurance of an Integrated Report prepared under the International Integrated Reporting Council’s framework, the IAASB should engage early in the process with preparers, users, auditors and the IIRC itself. One area where we believe the International Audit and Assurance Standards Board (IAASB) has not been responsive is that of cyber threats. Standard setters in different areas should seek to work more closely together to ensure that the different standards are mutually compatible and work effectively together.

However, in many environments the biggest inhibitor of innovation is the regulatory environment, not the standards. For example, for group audits, where the group auditor is responsible for the group audit but local laws prevent access to audit work papers for audits of subsidiaries or require the auditor of the subsidiary to rotate. Regulation may inhibit the application of standards and/or litigation risks may inhibit innovation by auditors.

Standards in some areas are rules-based, setting minimal standards, but generally international standards are principles-based. The international assurance standards have very limited rules and by their nature support innovation. If standards are too rules-based they will inhibit or prohibit innovation. There are significant variations in the application of international audit and assurance standards which implies that the standards are not rules-based, but it is fair to say that the IAASB clarified standards may not be as clear as the project implied (for example, in the area of group audits, materiality and related parties).

4. Do standards make our profession stand out? Why or why not?

We do not consider that standards in themselves make the accounting profession stand out, although they provide a very rigorous and demanding framework for the profession (for example, application of ISQC1 and the IESBA Code of Ethics both distinguish the profession from others that may be providing assurance on certain similar matters).

We believe that the accounting profession stands out due to the competence of its highly trained members, their ethical and professional behaviour, objectivity, independence and attitude of professional scepticism. The profession’s responsiveness to market needs and the sheer size and scope of its tasks which are proportionate to the increasing size of companies and the level of complexity of

their multiple activities also makes it stand out compared to other professions which may be considered to have a similar level of requirements for competence, training and ethics/professional behaviour.

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

Deloitte believes that integrity and objectivity are key and overarching principles in professional behaviour. Without these there can be no trust and without trust there can be no effective or reliable professional activity. In order to achieve this, activities need to occur in several places at a global standards setting level, at an organizational and engagement level, and also as part of university curricula.

Need for High Quality Global Standards:

As societies' expectations of professional accountants continue to increase, so does the need for consistent high quality global standards to provide a framework and guidance for professional accountants when evaluating matters that present challenges to the tenants of integrity and objectivity.

Inside the professional organization - Organizational and Engagement Level:

The future of audit and assurance depends on a profession that is focused on a relentless pursuit and demonstration of integrity in business. Professional organizations play a critical role in motivating and sustaining professional and ethical behaviour at two levels – the organizational level and the engagement level.

Professional organizations have a duty and responsibility to proactively plan, manage and build cultures that motivate and sustain ethical behaviour. An organization must clearly define its expectations of behaviour through policies, values, and codes of conduct. The organization must communicate these expectations to all levels of personnel and have processes and enforcement mechanisms in place to both encourage and support the right behaviours and take action when misconduct occurs.

To further the organization level actions and reinforce the importance of personal responsibility, the tone and leadership exhibited at the engagement level by individual partners is also critical. On-the-job training helps younger professionals better identify situations or matters that could present ethical dilemmas, looking beyond mere compliance with technical and professional standards, and to confidently address them by asking the difficult questions, seeking consultation with those who have more experience and receiving the full support and recognition of the organization when they display such behaviour. This daily leadership in action, coupled with recognition and reward mechanisms, are crucial to reinforce the importance of acting with integrity and objectivity.

Outside the professional organization - Role for Universities in Professional Education:

Ethical principles should be incorporated into all course work for today's and future students – their exposure to professional ethical dilemmas is critical to fostering practical skills for ethical decision-making in business. It is the obligation of the profession, working with the academic community, to provide innovative, experiential learning and leadership that will advance professional responsibility in business and society.

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

IT Innovation is impacting clients across all industries and sectors, and this in turn is impacting audit firms, including increasing opportunity and expectations to use technology-based audit techniques. In our view technology innovation for audit is a key area on which the profession should focus, to consider how technology can be used to perform better audits. In addition, the widespread use of technologies is eliminating traditional records and there is an increased reliance on IT records to support transactions and as an integral part of internal control processes, which necessitates changes in how we audit. And finally, there are rapidly growing cyber security needs, including for assurance on how well entities' financial data is protected from cyber risks.

Technology innovation has also made the use of analytics in audits more accessible due to increases in computer processing power and the wide proliferation of analytics tools and techniques. More financial and non-financial data is available to assist with risk assessment and analysis as part of the audit. The use of electronic audit techniques also allows the use of unstructured data as part of the audit. We are also seeing companies making greater use of cloud-based technologies, which will likely impact how financial data are managed, stored and controlled, and in turn also impact how we audit.

Technology innovation is making it possible to automate highly repetitive work, which is fast becoming commoditized in the audit process. Automation of many lower level, and possibly even some knowledge-based tasks will impact how we conduct our work and will also have a direct impact on the talent models of accounting firms.

Stakeholder expectations in a digital age are likely to evolve as individuals are becoming more used to easier and more immediate access to information, which could lead to changes in how companies are expected to report their financial performance and financial health. Should this shift in expectations occur, a change in how we conduct our audits will be necessitated, which can only be facilitated through embracing new technologies and innovations in data analytics.

Irrespective of this evolution, professional judgment will in any event remain fundamental for an auditor and will, like today, be acquired, developed and sharpened through practical work experience.

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?

It can be questioned whether the current education and training of professional accountants and auditors are still fit for purpose, for two main reasons:

1. The level of knowledge required by auditors is increasing, with the volume of accounting and auditing standards multiplying over the past 10 years and with the nature and extent of knowledge required of internal controls, data processing, IT systems due to the growth of ERP systems, complex networks, on-line access controls, cyber risks, mathematics, statistics and the internet. The level of investment in the education of auditors before qualifying as professional accountants has not extended at the same pace as the level of the knowledge auditors now require.

2. Although the level of continuing professional education for qualified auditors has significantly increased in both quality and volume across the EU, the rate of change in technology and standards and the sheer complexity of products and services provided by audited entities has also increased significantly.

From an audit industry perspective some of the challenges we face in learning are:

- regulatory pressures driving the focus on learning within the audit firms towards the technical areas (audit/accounting) and so reducing the time available to develop broader industry, leadership and professional judgment capabilities. This is important, as understanding of the entity is an increasingly important part of risk assessment for the financial audit, and will be even more important for assurance of non-financial information; and
- the need for increased learning and development activities given the rate of pace of innovation in learning and development and the use of technology.

Despite these challenges, there is a growing recognition of the importance of talent in the audit sector. The business imperative to recruit, retain and develop the best people is driving some substantial initiatives such as, for example, the Deloitte University initiatives⁶.

There is a need to clearly articulate what competences the auditors of the future will need to have in order to be successful, including an understanding of the transformational changes, such as technology innovation, impacting our profession. Training needs will then need to be matched against this “auditor of the future” competency model. These skills will include a deeper understanding of technology trends and broader skills related to analytics, but future auditors will also need to be equipped with broader people management skills and “soft skills”. As stakeholder expectations evolve, it is probable that auditors will be required to provide assurance on information beyond traditional financial information, which is going to require specialized skills and training. Whilst it is likely that auditors will have to rely on subject matter experts, the auditor of the future will need to have a broad base of knowledge of different types of risks and areas of expertise.

The education of professional accountants needs to be extended in time and nature. The extent and quality of continuing professional development (“CPD”) needs to be kept under review to ensure that all modern changes to systems, accounting and auditing standards are adequately incorporated into CPD education for all professional auditors, including extending the CPD to include soft skills required to improve the quality of services. Finally, the CPD curriculum needs to contain a mandatory common core and not be left solely to the practitioner to determine what to cover in their CPD. Others who contribute to the conduct of audits within an audit firm, such as actuaries, tax specialists and IT specialists should similarly be subject to appropriate mandatory CPD.

In reshaping the education and training needs of professional accountants and auditors, and without underplaying the very significant role that learning on the job from other (more) experienced accountants and auditors will continue to inevitably play, many factors need to be considered, including:

⁶ Deloitte launched Deloitte University Europe in 2013 with as objective to deliver cutting-edge learning that will develop the next generation of international business leaders and advisers, see <http://www2.deloitte.com/be/en/pages/about-deloitte/articles/belgium-selected-home-deloitte-university-emea.html>

- What sort of people does the accounting profession attract to a career (and whether/how that needs to change)?
- What role does the academic system play in developing accountants and auditors? How to influence this so that the right people are learning the right things at university?
- How do the accounting professional qualifications need to change to better reflect the current and future needs of accountants and auditors?
- What career paths do individuals need in order to build their skills appropriately in the workplace?
- What role do the regulators play in influencing the nature and focus of continuing professional development?

Within the US, a profession-wide review has been carried out over a number of years: the Pathways Commission⁷, which has been looking at how to tackle some of these issues in the US; it has been very heavily rooted in the academic environment because of the structure of the US profession and the central role academia plays but does provide an interesting example of an integrated response to these sorts of issues across the profession.

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?

In order to continue to attract, retain and develop top talent into our profession we will need to articulate a bold and bright future for professional accountants and auditors, a future that continues to develop business leaders who are equipped for the challenging and rapidly evolving business world.

We need to ensure that the competency map for the auditor of the future reflects the changing business world and that our coaching and talent development model reflects these skills. This competency model needs to recognize that the auditor of the future will require a diverse range of skills, and consequently this should not be a “one-size fits all” model. Training, education and development opportunities are needed to cover all aspects of the skills required by the auditors of the future. Key areas are not only technical skills in accounting and auditing but also soft skills and the knowledge of technologies, ERP systems, complex networks, on-line access controls, cyber risks, mathematics, statistics, the internet and evolving new technologies or business innovations. Audit practitioners will also need to be equipped to be highly adaptable and to embrace a culture of change and continuous learning, while maintaining professional scepticism and exercising professional judgment.

We must also acknowledge the need in the course of our audit and assurance work for more experts in specific fields such as, for example, valuation specialists, financial instruments or IT specialists, due to the increasing level of complexity of business operations and transactions.

⁷ See <http://www.journalofaccountancy.com/News/20126163.htm>

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?

Yes, we see merit in further exploring the suggested changes in auditor reporting (introduction of a grading system based on benchmarking, more frequent reporting, auditors using communication channels other than the audit report, more information about the auditor's conclusions regarding management's going concern assumptions and enhanced communication between the auditor and the audit committee or those charged with governance)⁸. Exploring these suggestions further can in our view do no harm and could result in significant benefits, particularly if a broad group of stakeholders gives their views on the value of these suggested changes.

The Rolls Royce audit report for the year ended 31 December 2013 illustrates how auditor reporting can be enhanced and that enhancement will be acknowledged by the investor community⁹. To quote Citi, this audit report "not only describes key risks in detail, but also explains the auditor's response and the auditor's findings. The auditor's findings included comments on whether RR management's judgements and estimates were appropriate or cautious/optimistic. We found this very useful." The introduction in audit reports on public interest entities of "key observations" with respect to the most significant assessed risks of material misstatement under the new EU audit regulation will in our view lead in the direction of this type of report.

The changes to International Standard on Auditing 'Forming an Opinion and Reporting on Financial Statements' (ISA 700)¹⁰ and the introduction of 'Communicating key audit matters in the independent auditor's report' (ISA 701) are a starting point and support the need to innovate going forward.

⁸ An incremental step in this direction has been the introduction in the UK of enhanced auditor reporting. Auditors of listed companies applying the UK's Corporate Governance Code, are required by ISA (UK and Ireland) 700 (revised) to provide real insight into how their audits are performed by:

- Describing the risks that had the greatest overall effect on the audit strategy, the allocation of resources in the audit, and the direction and efforts of the engagement team,
- Explaining how the concept of materiality was applied in planning and performing the audit,
- Giving an overview of the scope of the audit, showing how this addressed the risks described.

In addition, management are required to disclose the critical judgements formed and key estimates made by management in preparing the financial statements and the audit committee's report must include the significant issues it considered in relation to the financial statements, and how these issues were addressed.

⁹ See Citi 27 March 2014 report 'New UK Auditor's Reports', p.9,
http://icas.org.uk/uploadedFiles/Files/Technical_Knowledge/Audit/Research/Citigroup-on-UK-audit-reports.pdf

¹⁰ See [http://www.ifac.org/sites/default/files/publications/files/Proposed%20ISA%20700%20\(Revised\)-final.pdf](http://www.ifac.org/sites/default/files/publications/files/Proposed%20ISA%20700%20(Revised)-final.pdf)
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There is some concern that the IAASB standards-setting process with its compromises will not result in audit reporting evolving further, for example, the reporting of the auditors' work on going concern may be less far-reaching than originally proposed; that said, where going concern is a key audit matter (i.e. it required significant attention but did not ultimately result in a conclusion that there was a material uncertainty), this may nevertheless be discussed in the audit report. It will be important for the IAASB and the profession to work with prudential regulators as well as audit regulators in this area.

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

Yes, we think that there are other areas to be explored where we believe that the auditor's involvement could add value, including the following areas:

- Assurance on non-financial key performance indicators (KPIs)
- Assurance on the process for the creation of management commentary, for example where management prepares a report in accordance with the requirements for an integrated report as set out in the IIRC's International Integrated Reporting Framework
- Going beyond providing assurance/reporting on "management assertions" only
- Providing assurance on prospective/future-looking information
- Assurance for Earnings Announcements

Changes to increase areas of auditor's involvement will require changes in legislation in many jurisdictions (see our reply to question 1 above).

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

Yes, in our view these different users of the audit report seek assurance on different aspects. It is not clear to us what the distinction is between shareholders and investors but we assume that the investor category covers future shareholders too and aims to include institutional investors such as pension and other funds that invest on behalf of end beneficiaries. Investors do not have the ability to demand the information that management and/or banks can demand.

Banks obtain the assurance they require in different ways including through obtaining comfort letters, covenant letters and other assurance reports. Information provided to the bank (credit lenders) or management/those in charge of governance could be confidential and market sensitive.

Shareholders are typically considered to be seeking assurance over historic information and governance, i.e. the historic stewardship reports. However, many shareholders will of course be interested in assurance on forward-looking information and risks, to help them decide whether to remain shareholders, to acquire more shares or to divest their shares.

Those charged with governance, particularly independent or non-executive directors, also benefit from assurance from an audit and also engage auditors to provide other types of assurance reports. For example, commissioning additional assurance by auditors over non-financial reporting could give an audit committee comfort that management has prepared the information in an appropriate way. The behavioural impact of audit (the very fact that financial statements will be audited in itself incentivising

accurate processing and reporting of financial transactions) is also worth considering as auditors start to report on a wider range of subject matters.

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

There is no common standard for addressees of audit reports. This depends on the regulatory, legal and litigation environment in which the audit report is issued. There is a broad range of options and this should not be changed through international standards as the standards cannot provide protections from risks for the auditor that may result in the relevant jurisdiction. However, as mentioned in question 1, there should be further exploration of the different legal frameworks in which the auditor operates and discussion of the auditor's duties and responsibilities to different stakeholders.

Questions related to the focus on alternatives to better meet stakeholders' needs

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

The following ranges of services could in our view be usefully developed, depending upon stakeholders' needs: reasonable and limited assurance over a broader range of client information, processes and data, including information prepared for inclusion in

- Integrated Reports;
- Sustainability Reports;

as well as the range of services mentioned in the reply to question 10 above.

For any such services, both the cost/benefit analysis and the regulatory environment need to support assurance in these fields and there needs to be a willingness for practitioners to provide the service within their professional and regulatory environment. We would add that the assurance that can be provided over these types of reports needs to be analysed and debated with stakeholders and policy-makers.

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

FEE can be very instrumental in further developments, through examining the benefits and costs of such services, seeking the views of stakeholders on the value of these services and working on the parameters under which the profession would realistically be able to provide such services. FEE also has a role to play in sharing good practice and innovative approaches across Europe and beyond.

15 & 16 Is there a need to consider alternatives to statutory audit for SMEs? 16. How could the range of service offerings be adapted in order to meet current and future needs in the SME environment?

Where companies do not require an audit there is a need to consider a review type engagement.

The current standards should provide enough flexibility for both small and large audits although more guidance may be needed regarding their application to SMEs, particularly regarding the level of understanding of internal controls that is required.

17. Is the profession too focused on financial information?

Historically, yes. However, more recently there has though been a move to develop assurance standards relating to non-financial information (for example, greenhouse gas emissions statements). There is a need to move to focus on the needs of stakeholders, who are seeking assurance on other matters than historic financial information, including prospective financial information and other information. It is clear that qualitative information is valued, as has been demonstrated by the comments on the revised UK audit reports in 2013.

In our view, effecting change needs to be driven by the profession, based on the needs of stakeholders.

Education remains a challenge. The level of education required to attain the level of expertise that has driven the respect for the profession is ever increasing. Is the profession investing in the appropriate level of accounting and auditing education to maintain the standing of the accounting profession? Is the time to qualify as a professional accountant too short and are current new entrants adequately educated given the volume of knowledge required to maintain our profession's standing?

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

Yes, there appears to be market demand for auditors to comment and provide assurance on information included in the narrative reporting section of annual reports or similar, particularly regarding disclosed risk factors, with moderate support for assurance on director and executive remuneration¹¹.

As an initial point, some of this narrative reporting is already audited such as, for example, the Directors' Remuneration Reports issued by UK quoted companies. Other information included in narrative reporting may already be subject to a certain level of third party assurance or verification. For example, it may have been drawn from separate corporate and social responsibility reports or sustainability reports. It is important to note that there is significant overlap between the content requirements for an integrated report and narrative commentary in annual reports for quoted companies¹².

In addition to the question of the costs and benefits of assurance on narrative reporting in annual reports, there are also many linked factors to be taken into consideration, including the following:

¹¹ Future role of audit – a more insightful audit for a more complex world', Forbes Insights, p. 8-9, http://www.forbes.com/forbesinsights/future_role_of_audit/index.html

¹² An integrated report, prepared in accordance with the International Integrated Reporting <IR> Framework covers 8 content elements (organizational overview and external environment, governance, business model, risks and opportunities, strategy and resource allocation, performance, outlook and basis of preparation and presentation) prepared in accordance with 7 guiding principles (strategic focus and future orientation, connectivity of information, stakeholder relationships, materiality, conciseness, reliability and completeness, and consistency and comparability). In short, there is some overlap between the requirements for an integrated report and narrative commentary in annual reports for companies.

- whether the nature of the content is capable of consistent evaluation or measurement against specified and/or identified criteria, and can be subjected to evidence-gathering procedures¹³;
- difficulties for both preparers and auditors in determining and verifying inherently judgemental values;
- inherent valuation uncertainties in some non-financial data/metrics currently included in narrative report;
- the maturity of a company's relevant reporting systems and processes may also affect the ability to obtain assurance - immature systems and processes may not withstand the scrutiny of independent assurance;
- the type and level of assurance possible and whether there are relevant international assurance standards¹⁴.

Further stakeholder engagement is required to refine the demand for assurance on narrative reporting. Taking the case of integrated reporting as an indication, we would highlight that the dialogue around assurance is still at an early stage. Ultimately, a period of experimentation, and indeed experience, will be needed to establish whether or how assurance on an integrated report can really be achieved and to identify any inherent limitations in assurance provision. In developing an assurance model it may be necessary to target first those elements that can reasonably be assured and for which there is an assurance demand.

The 2013 Investor Critique of the annual reports of businesses in the IIRC's Pilot Programme for Integrated reporting for businesses¹⁵ noted, in amongst its recommendations, that business could "maintain credibility by ensuring the report content is:

- Balanced and unbiased
- Connected and insightful, as opposed to a simple restatement of information found elsewhere
- Aligned with key messaging across other corporate communications
- Substantiated, where appropriate, by credible third-party research, projections and estimates."

We believe that internal and external audit/assurance could have a significant role to play in integrated reporting and narrative reporting in the annual report. We believe that FEE can play a significant role in providing a forum for the profession to develop its thinking in this area and test this thinking with a wide range of stakeholders.

¹³ The question also needs to be raised as to whether the entity should be reporting information if the content is not capable of consistent evaluation or measurement against specified criteria.

¹⁴ In the absence of specific subject matter standards, ISAE 3000 would apply and the challenge for the practitioner is how to tailor the principles of ISAE 3000 to the specific subject matter in hand.

¹⁵ <http://www.theiirc.org/wp-content/uploads/2013/10/IIRC-Pilot-Programme-Investor-Critique-2013.pdf>

19. Will the market demand assurance on Corporate and Social Responsibility (CSR), Environmental, Social Governance (ESG) and Integrated Reporting (<IR>) as this type of reporting becomes more widespread? Why (not)?

Yes, we believe that the market is already demanding some assurance in these areas and that this demand will increase with increased corporate reporting in these areas. The reporting of CSR and ESG information is becoming more widespread for the top-tier listed companies. Many prepare standalone sustainability or CSR reports which contain both CSR and ESG information. Many of those companies seek independent assurance over the process for collation of that information¹⁶ and its reporting, in particular with the G4 Sustainability Reporting Guidelines, issued by the Global Reporting Initiative (GRI)¹⁷.

The more that this broader information becomes an integral part of a company's decision-making processes and part of their internal and/or external reporting information suite, the greater the likelihood for the need for increased comfort over the credibility of that information both internally at the Board of Director level and for the purposes of a company's broader stakeholder groups.

Stakeholder engagement (a G4 requirement and an <IR> Guiding Principle) is a significant component of a company's processes to identify risks and opportunities and which are the material issues it must face to ensure business as usual, profitability, a strong brand and reputation and continued resilience and success in an ever-changing world for which changing demographics and the competition for resources and talent are real issues. This implies the need for better reporting that is meaningful for stakeholders.

Furthermore, transparency of accountability is a real issue in the information age that we live in, which is also characterised by shareholder activism and multiple demands for responsible business behaviours in the wake of the financial crisis. Companies are increasingly expected by governments and by the ethical principles of good corporate governance to consider the impacts on the wider communities they operate in and to demonstrate that their actions and behaviours are not at the expense of the public interest. Again, this will serve to increase corporate reporting on a wider range of topics and the need for independent third party assurance on that reporting.

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

In the wake of the financial crisis, financial management and reporting in the public sector has come under increasing scrutiny. The audit profession plays an important role in helping governments gain greater accountability and transparency through the participation, advocacy, and implementation of the International Public Sector Accounting Standards (IPSAS).

Audit professionals' participation in the development of public sector accounting standards is critical to helping governments achieve high-quality financial reporting. They can contribute in many ways including: serving as International Public Sector Accounting Standards Board (IPSASB) members, providing funding for IPSASB, and commenting on due process documents.

¹⁶ The focus should of course be on data quality too, not simply on the data collation process.

¹⁷ See <https://www.globalreporting.org/reporting/g4/Pages/default.aspx>

Furthermore, audit professionals play an integral role in building awareness and advocating IPSAS through published articles and books, training seminars and workshops, establishing accreditation programs, and developing products that enable effective and efficient IPSAS implementation.

It is also important that the audit profession directly support public sector entities in their IPSAS implementation efforts. In addition to sharing best practices and implementation success stories across public sector organizations, audit professionals also perform an array of services including the development and preparation of impact assessments, implementation strategies, accounting policies and procedures, accounting manuals, chart of accounts, and opening statements of financial position. Beyond implementation services, further support of the maintenance of IPSAS standards includes quality control and audits of IPSAS financial statements, and responding to technical questions as they arise during the preparation of financial statements.

Credible and transparent financial reporting across public sector entities is not just important, it's imperative to ensuring effective government performance. In helping governments achieve this, the audit profession is playing a central role in supporting global fiscal stability and sustainability.

Question related to the conclusion

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

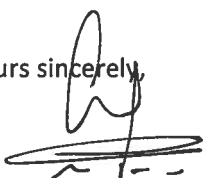
The question of the extent to which the auditor has, or should have, a duty to serve the public interest, including how the public interest should be defined, could be usefully considered in this debate. Our vision of audit is that of an independent, private-sector profession that is subject to public oversight, operates in a free market, reports publicly on corporate financial reporting (and increasingly, non-financial reporting) and is held accountable to the public interest. Both the requirements for corporate reporting and for audits and the role, function and powers of the auditor are set by law. Demanding professional qualifications, ethics standards and public oversight form the basis for audit quality. In our view, this is an effective and efficient model. We also believe that auditors have a wider societal role, including with regard to financial stability; this role merits further debate with stakeholders¹⁸.

Another topic that we would suggest FEE explore further is the issue of cross-border mobility of auditors, both within the EU and beyond. Given the increasing complexity of the business carried out by audited entities, their sheer size and the increased areas of competences needed to carry out audits, increased auditor mobility could contribute to audit quality.

Finally, the issue of how to make audit legislation fit-for-purpose in today's globalized world can usefully be debated by FEE with politicians, regulators and other law or policy-makers. Unduly complex and globally inconsistent legislation will increase costs for audited entities and auditors, and risks leading to a culture where significant audit firm resources are devoted to compliance, with no clear benefit for audit quality and innovation.

¹⁸ See Deloitte cover letter reply to EC green paper on audit policy, p. 1 <https://circabc.europa.eu/sd/a/467833c6-0545-4765-b577-6b4b256ef47c/Deloitte%201%20en.pdf>

We remain at your disposal to discuss any of the points raised above or any other questions you may have and look forward to continuing the debate on the future of audit and assurance with FEE and other stakeholders.

Yours sincerely,


Gérard Trémolière
Managing Director European Regulatory Affairs
Deloitte Touche Tohmatsu