

<p><b>Institution:</b> University of Stirling</p>
<p><b>Unit of Assessment:</b> C19 Business and Management Studies</p>
<p><b>Title of case study:</b> The Future of External Assurance: User and Auditor Perspectives</p>
<p><b>1. Summary of the impact</b></p> <p>The perceptions of key user and auditor constituencies on contemporary issues in audit and assurance may differ radically. The research carried out in this critically important area impacted directly on proposals put forward by the Institute of Chartered Accountants of Scotland (ICAS) on <i>The Future of Assurance (henceforth FoA)</i>. Ian Fraser was a member of the ICAS working party which developed <i>FoA</i>. Several research findings impacted on the <i>FoA</i> proposals; key examples include the proposals that assurance should be provided on annual corporate report content other than the financial statements and that audit reports should contain judgemental and entity-specific information. Subsequent to the publication of <i>FoA</i>, ICAS has published a further discussion paper, <i>Balanced and Reasonable (henceforth BaR)</i>, which further progresses the public discourse on a key element (namely the provision of positive assurance by the external auditor on management commentary and on the general narrative information in the annual report) both of <i>FoA</i> and of the underlying research.</p>
<p><b>2. Underpinning research</b></p> <p>Pressure from investors and other users has led to a growing realisation not only that assurance is not presently provided on the most appropriate matters but that the form and content of the associated reporting to users requires to be revised radically. There is a sense auditor-shareholder relationships might be enhanced while there are concerns about audit quality including the emphases placed on process and on judgement. The recent financial and economic crisis led to these issues featuring in professional, regulatory and political discourse. Initiatives by regulators and accounting users' concerns have coalesced to provide opportunities for policy-orientated research concerned to radically reform external audit and assurance: (1) The issue of a discussion paper (IASB, 2005) and exposure draft (IASB, 2009) by the International Accounting Standards Board created an opportunity to identify whether or not users had a demand for assurance on the 'front end' of corporate annual reports and whether or not auditors were able and willing to respond appropriately. (2) Contemporary public discourse, grounded in the concerns of users, on the value of audit reports, together with some response by regulators (e.g. APB, 2007) created a opportunity to examine user and auditor views on the efficacy of external audit reports. (3) Issues (1) and (2) resonate with continuing debate over the robustness of the external audit process and, for example, the relative emphases within it of process and judgement.</p> <p><b>Research Synopsis and Chronology:</b> ICAS funded Ian Fraser to conduct a two stage research project into issue (1) above. The opportunity to investigate issues (2), and to a lesser extent, (3) above was also taken because of their congruence with the main research concerns. A further issue (4), concerned with auditor-investor dialogue and the possible need to enhance this (see GAID, 2009), did not form part of the original research; it emerged from its first stage and was incorporated within its second stage. The execution of the research coincided with the 2008 financial crisis and its aftermath when external auditors were under scrutiny. The first research stage, exploring the views of accounting users, took place in late 2008 coinciding with the banking and financial crisis. The second research stage, exploring auditor views, took place in late 2009 and early 2010 when the external audit was the subject of extensive scrutiny. The research addressed the following key issues: the importance to users of external assurance on the 'front-end' of annual reports, the form of assurance which might be adopted, external users' confidence in audit reports and how that might be enhanced and the feasibility of other forms of auditor-user communication. These questions were addressed through (1) three questionnaire surveys, two of different groups (investors and others) of financial statement users and one of audit partners, and (2) two series of semi-structured interviews with users and auditors respectively.</p>

**Key insights and findings** Both auditors and users viewed providing assurance on the ‘front-end’ of the annual report as desirable; obstacles envisaged by auditors were not primarily technical but were issues such as reporting content and litigation, users appeared only mildly confident in the audit process; auditors acknowledged the need for some rebalancing of judgement and process in the audit process, users perceived existing audit reports to be of little use and in need of radical revision; more specifically, reports might incorporate more entity-specific information and to better reflect auditor judgements; there appeared to be scope for other initiatives to enhance auditor-investor dialogue.

**Chronology and key researcher** The first stage of the research (investors) took place from October 2008 to January 2009. The second stage (auditors) took place from October 2009 to January 2010. The key researcher in both phases was Ian Fraser (Professor of Accounting, University of Stirling, throughout the research).

### 3. References to the research

#### Peer Refereed Research Monographs

**Fraser, IAM, Henry, WM, Pierpoint, J and Collins, WM (2010)**, *Meeting the needs? User views on external assurance and management commentary*, The Institute of Chartered Accountants of Scotland, Edinburgh. 175 pages, ISBN 978-1-904574-65-1;

**Fraser, IAM, and Pierpoint, J (2011)**, *Can we meet the needs? Auditor views on external assurance and management commentary*, The Institute of Chartered Accountants of Scotland, Edinburgh. 162 pages, ISBN 978-1-904574-81-1

#### Summaries of the above research monographs

**Fraser, IAM and Henry, WM (2010)**, *Meeting the needs? User views on external assurance and management commentary*. Research Summary, The Institute of Chartered Accountants of Scotland, Edinburgh. 33 pages, ISBN 978-1-904574-11-8;

**Fraser, IAM (2011a)**, *Can we meet the needs? Auditor views on external assurance and management commentary*. Research Summary, The Institute of Chartered Accountants of Scotland, Edinburgh. 31 pages, ISBN 978-1-904574-77-4

#### Articles in professional press

**Fraser, IAM and Henry, WM (2009)**, *Ticking the commentary box*, CA Magazine, October, p.58;

**Fraser, IAM (2010a)**, *You say you want a revolution*, CA Magazine, June, p.54;

**Fraser, IAM (2010b)**, *An appetite for revolution*, CA Magazine, July, p.58;

**Fraser, IAM (2011b)**, *Points of view*, CA Magazine, July, p.60-61.

**Grant information** The project was funded by a grant (Title: The future of assurance: a focus on the management commentary discussion paper of the IASB) of £22,000 from ICAS. This was awarded to Ian Fraser and the period of funding ran from March 2008 to February 2010.

### 4. Details of the impact

The principal impact of the research has been on proposals developed by the Institute of Chartered Accountants of Scotland on FoA in 2010. The loss of confidence in both corporate reporting and assurance led ICAS to establish an expert working party to develop proposals for a revised model of external assurance. Fraser was the only academic on the working party which consisted of around 14 members representing senior representatives of the auditing profession, as well as senior preparers and users of accounting information. The deliberations of the working party were observed by regulators from the Financial Services Agency (FSA) and the Financial Reporting Council (FRC). A number of the FoA recommendations ‘have been taken forward, either by bodies such as the Financial Reporting Council (FRC), or have been backed by respected bodies such as the House of Lords Economic Affairs Committee’ (BaR, p1).

## Impact case study (REF3b)

The research served as a starting point for the deliberations of the working party and the *FoA* report referred explicitly to it; see ICAS (2010) p11, p30. The working party's proposals were published at the end of 2010 and reflect the impact of the research in several identifiable respects. The following pairs of paragraphs describe briefly (a) several of the key research findings followed by (b) the corresponding recommendations in *FoA*.

1(a) *Research finding* users believed that assurance on the 'front end' of the annual report [i.e. the annual report other than the financial reports themselves] was desirable.

1(b) *Future of Assurance proposal* The external audit and assurance report would include (inter alia) 'an opinion that the annual report (excluding the financial statements) is balanced and reasonable' (p.28).

2(a) *Research finding* Any obstacles envisaged by auditors to providing assurance on the 'front-end' of the financial report were not technical but factors such as the appropriateness of the existing (i) 'true and fair' opinion and (ii) possible litigation difficulties.

2(b) *Future of Assurance proposal* (i) As noted above the form of assurance envisaged for the 'front-end' is couched in terms of 'balance and reasonableness' rather than 'truth and fairness' (p.28). (ii) It is recommended that the 'liability regime for directors and external auditors is carefully examined. To achieve our vision, there should be safe harbours for directors and a proportionate liability regime for external auditors' (p.28).

3(a) *Research finding* Audit reports might incorporate more entity-specific information and to better reflect the judgements made by auditors.

3(b) *Future of Assurance proposal* *FoA* did not implement this research finding believing that the audit committee rather than the audit report was the most appropriate locus for this kind of information. The research findings, however, are reflected in the *FoA* proposal that the audit committee report should explain how the committee has satisfied itself that 'the risk and control processes are operating satisfactorily' (p.22) and 'the appropriateness of management's significant judgements' (p.22). These proposals are linked to the audit report by the further proposal that the audit report confirms that the 'audit committee report contains an appropriate reflection of the key issues discussed between the audit committee and the external auditor' (p.28)

4 (a) *Research finding* There is scope to enhance auditor-investor dialogue.

4(b) *Future of Assurance proposal* While it was considered that there were too many obstacles to direct auditor-investor dialogue, it was recommended as an alternative that investors should challenge the audit committee and the Board where they have any concerns relating to the independence or objectivity of the external auditor'(p.29) and 'notify the company of any concerns on the appointment of the external auditor' (p.29)

The critical impact of the research on *FoA* is summarised by the ICAS Executive Director of Technical Policy and Services as follows: '*In summary, the research document was a very useful foundation for the considerations of the Working Party, and Ian's own input to the WP's discussions in highlighting aspects of the research and contributing to the evolution of the WP's thinking was really helpful. Through the broad and very senior membership of the WP and their engagement or relationships with other policy bodies, you can see that the research and the deliberations of the group have been influential in the development of policy at those bodies - thinking in particular of the FRC and its Effective Company Stewardship paper of January 2011. The FoA report has been used extensively by ICAS - as a basis for discussions with the European Commission, with the UK Government (BIS), at the Federation des Experts-Comptables Europeens, and with the Global Accounting Alliance. It has also informed and shaped the Institute's policy on how to evolve and develop the audit to be of greater use to the users of corporate reports, and in particular in forming the Institute's policy in relation to the European Commission's proposed legislation which was issued in November 2011.*'

As noted above, *FoA* has been followed in 2013 by *BaR*. *BaR* is grounded firmly in *FoA* and

## Impact case study (REF3b)

'suggests some of the processes that the auditor should follow when delivering an opinion on the narrative information' (p3). *BaR* cites (p.5) the two primary research outputs, Fraser et al. (2010) and Fraser and Pierpoint (2011) in support of its underlying arguments, ICAS now intends to expose *BaR* to more extensive exposure with plans to hold workshops in Edinburgh and London during the latter part of 2013.

**Subsidiary impacts** (1) Articles in the professional and business press by the researchers themselves. (Fraser and Henry, 2009; Fraser (2010a, 2010b, 2011b).and by independent commentators on it (Jubb 2010; Sanderson 2010). One example of endorsement by the business community is that of Jubb, head of Corporate Governance and Stewardship at Standard Life: 'Capital markets are placing more reliance on narrative reporting and investors need meaningful assurance. Recent research on user views, led by Professor Ian Fraser of Stirling University, with support from ICAS, reinforces this point convincingly' (2010, p.1). This statement appeared on the front page of *Accountancy Age*, a weekly publication available freely to all members of the main UK professional accountancy bodies. (2) Presentation of the findings in July 2010 at a breakfast event in the city of London hosted jointly by Grant Thornton PLC and ICAS and attended by senior users and auditors and representatives of regulatory and professional bodies including the FSA, the FRC, the Institute of Chartered Accountants of England and Wales (ICAEW) and HM Treasury. This event was covered by publications including the Financial Times and *Accountancy Age*. It was chaired by the president of ICAS and presenters included the previous chair of the House of Commons Treasury Committee, Lord John McFall. (3) An international presentation of the findings at the University of Luxembourg in September 2010 to representatives of the international financial community. (4) Fraser was invited to speak on the Future of Assurance at the 2010 Congress of the International Association for Accounting Education and Research (IAAER) in Singapore in November 2010. (5) Two presentations to the Audit and Assurance Committee of ICAS. (6) Hermes Equity Ownership Services Ltd referred to the research in their consultation response to the Treasury's discussion paper on Audit Quality in May 2010.

**5. Sources to corroborate the impact**

ICAS (2010), *The Future of Assurance*, ICAS, Edinburgh.

ICAS (2013), *Balanced and Reasonable*, ICAS, Edinburgh

Jubb, G. (2010), *Viva La audit revolution*, *Accountancy Age*, 20 May.

Sanderson, R. (2010), *Business leaders eye joined-up reporting*, 4 August.

FAS & FRC Discussion Paper 10/3: Enhancing the Auditor's Contribution to Prudential Regulation.

Referred to research in evidence given by ICAS to the House of Lords Economic Affairs Committee inquiry on Auditors: Market Concentration and their Role.

<http://www.publications.parliament.uk/pa/ld201011/ldselect/ldconaf/119/10101905.htm>

Global Accounting Alliance (GAA) *Accounting*: August 2010, Vol.3 No4, 'External Assurance: Meeting the needs?'