Assurance today and tomorrow

Audit and assurance: understanding investment professionals' needs today and tomorrow

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Invaluable insights from the investment community

Foreword

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Since audit is critical to market confidence in financial reporting, the contribution of investors and analysts to the current debate on audit is vitally important.

The needs of the users of financial statements drives demand for reliable, relevant and timely reporting and assurance.

Just as the world is re-examining its view of the capital market system in the wake of the financial crisis, it is timely for us to take the opportunity to re-examine the audit so that it remains reliable, relevant and valued in the future. The audit underpins market confidence in a company's financial reporting, so the contribution of investors and analysts in this debate is vitally important, although not often heard. We asked mainstream investment professionals around the world for their views.

This report summarises the in-depth interviews we carried out with 104 investors and analysts from 11 capital markets. We explored their perceptions of audit today, and their views on what could be done by auditors and others to enhance the value they gain from audit and assurance.

Through these interviews, we heard a number of different opinions and some powerful observations and insights:

- ***An audit is highly valued – investment professionals tell us they derive a high level of value from the fact that an audit has been undertaken.***

  However, a number of those we interviewed suggested that they do not always read the audit report or the audit committee report.

- ***Many interviewees have never talked with an audit committee member and don't fully understand what they do.***

  The audit committee, or its equivalent, is the representative of the shareholders, so it is important that shareholders understand what they do and how they do it. The audit committee's knowledge and insight into the audit and its oversight of the company's financial reporting and internal control systems should underpin investor confidence. We strongly support the initiatives underway in the US, UK, European Union and internationally to explore how transparency about the audit committee and its oversight of the audit can be enhanced.

- ***It's quality, not quantity, that matters.***
  Many of those interviewed would like additional insights from the audit, but not more disclosure for the sake of it. Given the interconnectivity of the corporate reporting system, they are wary of any unintended consequences of well-intentioned actions, concerned about impeding frank dialogues between auditors, management and audit committees, and added information simply becoming boilerplate statements.
- ***There is interest in a higher level of assurance over the metrics that move markets.***
  It didn't surprise us that investment professionals we interviewed are interested in assurance over – for example, industry-specific metrics and key non-GAAP numbers, particularly if some ground rules or standard definitions can be developed. Some participants expressed concern that the imposition of new assurance standards might result in fewer disclosures by management.
- ***.... and more timely assurance of the information investment professionals rely on.***
  Those interviewed say they often rely on information contained in preliminary announcements, and a number indicated that they ideally would like timely assurance at that stage. Many erroneously believe that the information in the preliminary announcement is audited. In fact, the audit of the full financial statements and notes may not be completed when the preliminary announcement is issued.

Change takes time but these insights into the views of investment professionals strengthen our determination to continue to work for reform in the corporate reporting environment as a whole. Currently the auditor reports at a single point in time on one element, albeit an extremely important one, of the wide-ranging total information package that companies publish. Let's together decide how the information set should evolve and then consider the role audit, assurance and audit committees should play.

The high-level of focus on these issues by all stakeholders in the capital markets presents a huge and exciting opportunity for change. There are challenges that auditors can and must respond to, but the audit alone cannot solve all the issues and demands on the capital market information system. The model as a whole needs further consideration involving all participants in the system. Longer-term aspirations will not deter us from taking a lead in looking at what might be possible in the short term to achieve genuine improvements.

I hope this report gives a clear insight into investor and analyst concerns and acts as a further stimulus for action. Capital markets are critical to the world economy and those markets cannot function without the relevant, reliable and timely information that the audit helps to provide.

Richard Sexton

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Overview

This survey, conducted across 11 territories, highlights the views of investment professionals on audit as it is today and on possible changes for the future. The impact of local circumstances and debates on participants' views are evident. Nevertheless some clear messages and common themes emerge.

- The investment professionals we interviewed for this study value the audit. Audit opinions influence their investment decisions. However, they would like audit and assurance to develop to meet evolving needs.

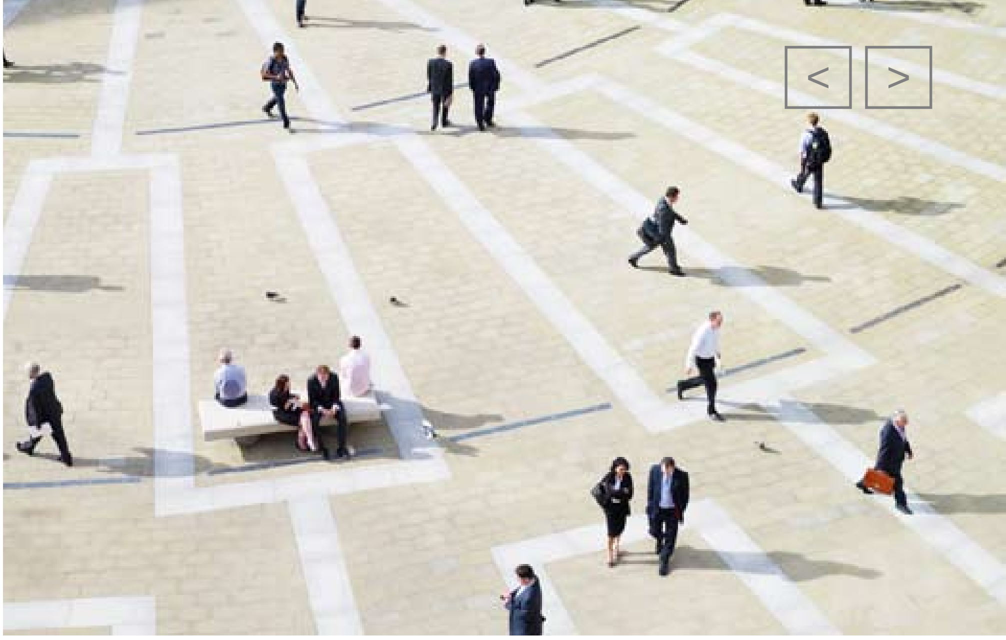
- They have a strong appetite for added insight into certain aspects of the audit and believe that management, audit committees and auditors all have their part to play in providing that additional insight.

- However, our discussions with many of the investors and analysts revealed that they understand the tensions that can arise between providing more information and maintaining the quality of disclosures, and between achieving greater transparency into the audit and the auditor's views on the entity's financial reporting, while maintaining the openness and honesty of discussions that are so important to audit quality.

- Assurance is sought on metrics that fall outside the current scope of the audit. The areas on which assurance is sought vary significantly by geography, but common themes are non-GAAP figures, industry-specific metrics and the remuneration report.

- Far more of those interviewed than not consider the audit profession to be sufficiently independent. However, some interviewees suggested during our discussions that confidence in the profession's independence could be further increased by more regular dialogue between investment professionals and auditors.

- Very few of the survey participants have had direct access to audit committee members. This creates uncertainty in their minds about the role of audit committees and the degree to which audit committees act as an independent check on management and are effective in overseeing the audit on behalf of shareholders.



Survey sample

The findings in this report are based on interviews conducted with 104 investment professionals located in 11 countries. We have analysed the results within the following categories:

- Asia Pacific (Australia, Hong Kong, Japan and New Zealand)
- North America (Canada and US)
- Emerging markets (Brazil and India)
- Europe (France, Germany and UK)

See the appendix on page 31 for details.

In this report, we typically highlight global results, except where there are notably different responses among different types of investment professional or between countries.

Audit today

Our interviews with investment professionals confirm that today's audit is valued internationally, across all the capital markets surveyed.

This doesn't mean that investment professionals always read audit reports. The investment professionals we interviewed tell us that, in general, they do not routinely read audit opinions on every company in their portfolios. However, they are unlikely to invest in a company with a qualified audit opinion. They also acknowledge that they cannot themselves access the information they need to perform their own due diligence. The fact that an auditor provides assurance on the primary financial statements is a source of comfort.

Whether the audit opinion is routinely read varies according to a number of factors, including the jurisdiction in which a company is listed, its market capitalisation and its history. The type of investor is also a factor – the equity investors we interviewed are less likely to routinely read the report than their fixed income peers.

Interest in and views on audit committees (or equivalent bodies of those charged with governance) vary considerably in different territories, influenced by the nature of local debate in the post-crisis period. However, in general, audit committees are not perceived to be as independent of management as auditors – 26% agreed or strongly agreed that audit committees are sufficiently independent, 35% are neutral but 39% of those we talked to disagreed or strongly disagreed that audit committees were sufficiently independent of management.

More value from today's audits

Among the investment professionals we interviewed, there is an appetite for more insight into today's audit. This was particularly the case among participants from emerging markets. Despite their desire for more insight, they recognise it may not be possible through the auditor's report. Many of those investors and analysts remain unsure about how the auditor's reports can be expanded in practice to really add value; they fear that the result could be boilerplate statements. In a similar vein, a number of those interviewed raised concerns about potential unintended consequences from added disclosure. They question, for example, whether the debate between auditor and management or the audit committee would become less frank if it were known that elements of that dialogue would be reported externally.

Investment professionals we spoke to tell us they would most value insights into the 'aggressiveness' of a company's financial statements – for example, in terms of the accounting policies applied and the judgements made by management. However, participants see the difficulty of providing meaningful insight, querying how 'aggressiveness' could be defined or benchmarked in practice.

Our survey indicates that investment professionals are relatively content with the information available to them on going concern, particularly those operating in mature markets and/or following 'large cap' companies. Nevertheless, during our discussions, many respondents suggested that better covenant information would be valuable – a view relevant to corporate reporters as well as standards setters and regulators who prescribe the required content of annual reports.

Some participants see value in expanding the audit opinion to cover the reasonableness and completeness of audit committee reports. Views on this are particularly strong in the UK, where there has been much debate recently about how to strengthen the role of the audit committees and the quality of their reports.

Assurance tomorrow

The appetite for assurance on other information varies. There are geographical variations, with participants based in emerging markets placing particularly high value on independent assurance in general.

The investment professionals we interviewed express strong support for robust assurance over the metrics that move markets – most notably non-GAAP and industry-specific metrics – particularly if some ground rules or standard definitions can be developed. But participants would not want the imposition of new assurance standards to result in fewer disclosures by management. They would typically rather have more data, even if that means it has to remain unassured.

In the governance arena, there is strong support among our survey participants for robust assurance over directors' remuneration reports. In contrast, there is less appetite for assurance over corporate social responsibility (CSR) information – unless it is value-relevant. The exception is in the emerging markets, where the investment professionals surveyed would appreciate a high level of assurance on CSR information in general, perhaps reflecting negative local experiences in relation to environmental and other CSR matters.

The vast majority of participants want the highest level of assurance to continue for the primary financial statements and accompanying notes, but there is appetite too for earnings releases (preliminary announcements) to include an assurance report. That said, a number of participants take comfort from the huge reputational damage caused to companies by any need to restate preliminary results; they assume that the penalty for those who revise is sufficient to focus management's attention on the accuracy of the preliminary results.

The investors and analysts we consulted are generally keen to have more dialogue with auditors. They are particularly interested in gaining better insights through the audit report – such as into the key judgements made by management when preparing the financial statements. There is an important role here for members of the audit profession to play in helping the overall reporting system to meet better the information needs of investment professionals.

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Audit today

We were keen to understand from our interviews how investment professionals around the world view today's audit – particularly the value they attach to it, the perceived independence of auditors and audit committees, and the role played by audit committees themselves.

Overall we found that the perceived value of audit – and assurance in general – among members of the investment community continues to be high.

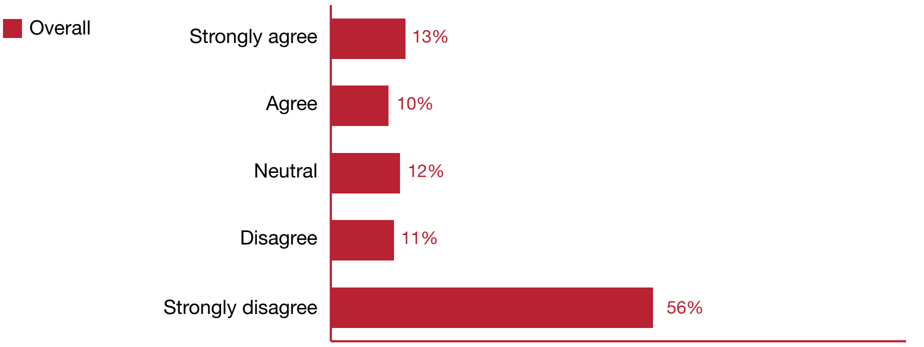
Value of the audit

'Anybody that thinks they can find out everything they know about a company from the outside is dreaming in colour.'

The investors and analysts we spoke to told us that they do value audit. This was a consistent message from all those we interviewed. They appreciate that the audit provides them with a degree of comfort that they cannot obtain from their own due diligence. Over two-thirds of participants (67%) disagreed or disagreed strongly with the statement *'Knowing that data is audited does not matter to me because I always do my own due diligence'*; just 23% agreed or strongly agreed.

A company's failure to gain a clean audit report is seen as a powerful warning-sign against investment. Over three-quarters (77%) of the investment professionals we talked to agreed or strongly agreed that they would be unlikely to invest in a company that had a modified or qualified audit opinion.

Figure 1: Knowing that data is audited does not matter to me because I always do my own due diligence.



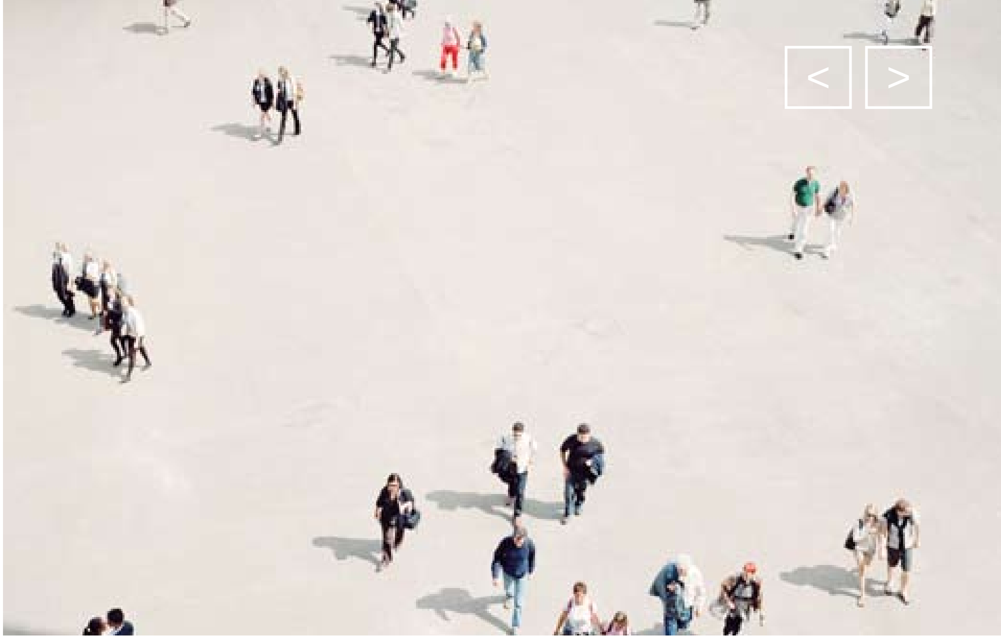
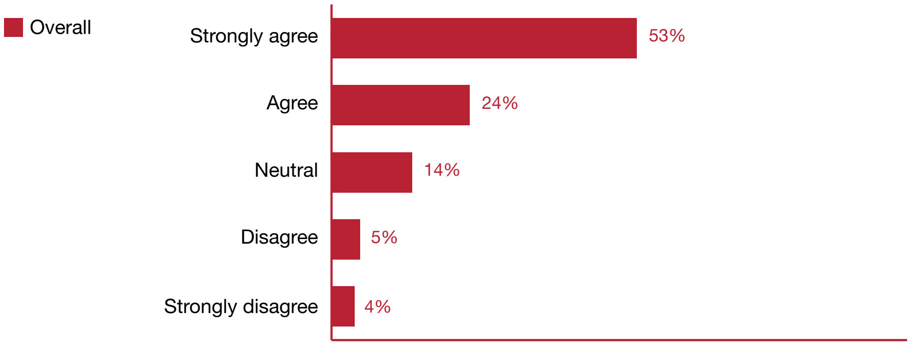


Figure 2: I would be unlikely to invest in a company that has a modified/qualified audit opinion.



'I'm terrified if they didn't get a clean audit opinion.'

Usefulness of audit opinions

'The only time I would ever read audit opinions is if there's something contentious in it. They are very few and far between.'

This isn't to say that investment professionals we talked to will generally read every audit opinion as a matter of course. In fact, 43% of the investment professionals we surveyed disagreed or strongly disagreed with the statement *'I always read the audit opinion on the companies I follow'*.

'If it's anything other than a tick, you'll have heard in the papers before you get the annual report.'

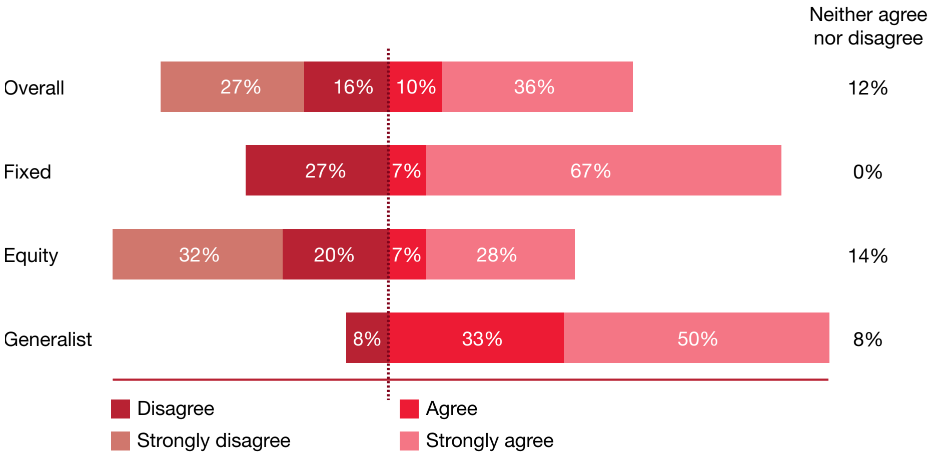
'It is a copy-and-paste template and adds no value.'

The propensity to read the audit opinion varies by type of investment professional, with representatives of the generalist and fixed income community much more likely to do so than their equity peers. One reason for this could perhaps be that fixed income specialists are looking for any emphasis of matter that might indicate liquidity or going concern issues. Equity investment professionals told us they would be alerted to any such issues by reports in the press or by sell-side analysts.

Those we interviewed from the Asia-Pacific region and the UK are less likely to read audit reports than those from emerging markets and continental Europe. Part of the explanation may relate to the varying content contained in audit reports across jurisdictions.

In India and France, for example, audit reports include more entity-specific commentary, which might increase their interest to investment professionals.

Figure 3.1: I always read the audit opinion on companies I follow

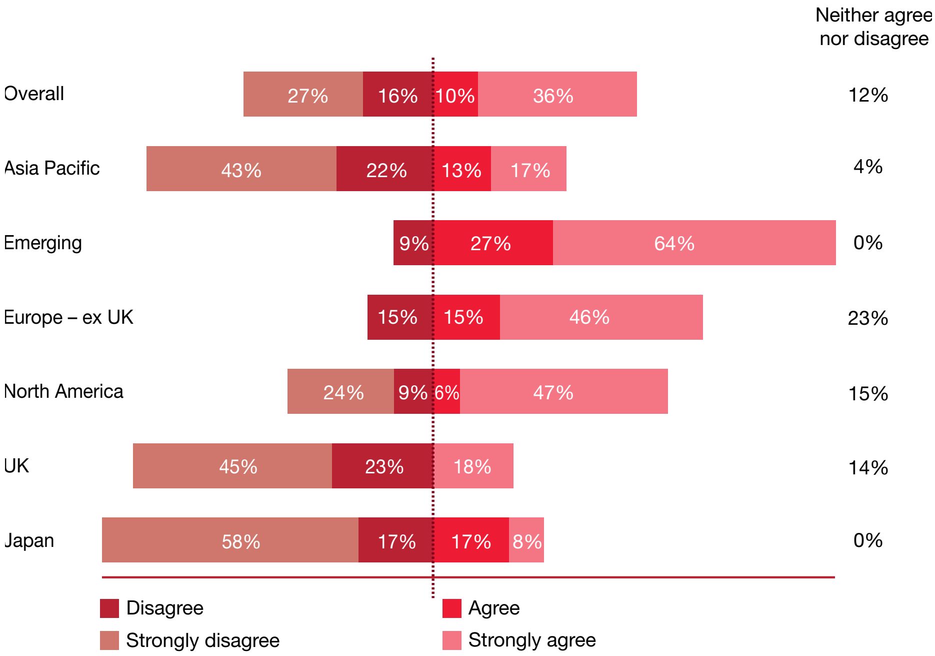


‘We look at listed emerging market companies, and there, the name on the report and the report’s content makes a difference.’

The views of those we interviewed in France may provide an interesting perspective into the international debates about how the audit report could be made more useful to the investment community. The majority of the investment professionals we spoke to in France do look at the ‘justification of assessments’ section within the audit report. However, of those who do, only 57% find it useful – a relatively low proportion – with around one in three (29%) of those who read the ‘justification of assessments’ saying they do not find it useful. These findings may reflect the general tendency for such content to have become increasingly boilerplate as time goes by. So it would appear that while investment professionals in France may decide that having this content is better than nothing, it is not a particularly valuable source of insight.

We asked the survey participants for their views on the timeliness of the audit opinion. Of all the investment professionals we talked to, 30% agreed or strongly agreed with the statement that *‘the audit opinion arrives too late for it to add to my assessment of a company’*; by contrast 44% disagreed or strongly disagreed, indicating that they believe the opinion to be sufficiently timely.

Figure 3.2: I always read the audit opinion on companies I follow



Regional variations in responses may reflect the differences in filing deadlines. Practices vary quite significantly, with many of the more established markets requiring three months; large accelerated filers in the US have to file within two months; and the UK listing rules require companies to do so within four months. Taking this into account, the views of UK participants stand out from the rest, revealing a strong appetite for more timely delivery of the audit opinion in the UK. A number of investors and analysts we spoke to in the UK mentioned the small but growing number of companies that issue their audited financial statements at the same time as their earnings release. They questioned why the wider corporate community did not do the same. Their keenness for the timely release of audited financial statements may be because they interpret this as an indicator of good internal controls within the reporting entity.

‘We like companies that are organised and efficient enough to have a full set of audited accounts in the preliminary announcements. I don’t think it [the audit opinion] arrives too late, but it would be good if it came out the same time as the company announces the results.’

Independence of auditors and the audit committee

‘Auditors should focus more on serving investors than audit clients.’

‘The only real conflict is that auditors are paid by companies. But we can’t actually think of a better way to do it.’

‘I’m not afraid of the independence of the audit, because the risk of failure is catastrophic. You’re going to get rid of the client before risking the firm.’

Asked whether they believe auditors are sufficiently independent of management, 46% of those we interviewed agreed or strongly agreed with this statement; only 25% disagreed or strongly disagreed.

Based on this response, it seems that some in the investment community may not agree with a theme emerging from various regulators around the world that auditors are not sufficiently independent. However, some did express concern during our discussions that auditors appear to be ‘on the side of the preparers’ rather than the investors.

The fact that audits are paid for by management is the issue most frequently cited as potentially compromising auditor independence. However, many do not see any practical alternative to the current funding model, with just a few of the investors and analysts we spoke to suggesting it could be addressed by establishing an independent fund to pay for audits.

A number of the investment professionals surveyed told us that they take comfort from the fact that when an audit firm is found to have failed to deliver an effective audit, the firm suffers a severe penalty through the negative impact on its reputation. The desire to avoid such reputational damage is seen as a strong incentive for firms to maintain high audit standards.

‘I tend to believe that auditors, or at least large firms of auditors, are quite independent. Occasionally there may be lapses and I’d be surprised if there weren’t. But broadly speaking I think probably auditors have too much at stake to be too close to management.’

As a leading global audit network, we fully endorse the assessment of many of these investment professionals that, for audit firms, fear of the reputational damage that would result from a true audit failure helps to incentivise high-quality work. The success of our business depends on trust; once that is damaged, our licence to operate is severely compromised. This is an informal yet powerful lever supporting the corporate governance framework.

Our discussions with investment professionals reveal, however, that many have only a hazy understanding of the formal controls that exist to promote independence, such as the periodic rotation of the lead audit partner and the external reviews of auditors’ work that take place. This indicates that the audit profession needs to do a better job in communicating the nature and extent of all such controls and could, in so doing, enhance confidence in the audit environment. By explaining current controls on auditor independence, we can help investment professionals reach informed views on whether those controls are sufficient. If they decide they are not, such communication could also stimulate discussion on the potential for doing more.

'You can't see how independent audit committees are because you can't see the debate that's gone on in the background.'

The investment professionals we spoke to have greater doubts about the independence of audit committees. 26% agree or strongly agree that they are sufficiently independent of management; 35% are neutral; and 39% disagree or strongly disagree with the idea that audit committees are sufficiently independent.

Figure 4: Are auditors and audit committees sufficiently independent of management?

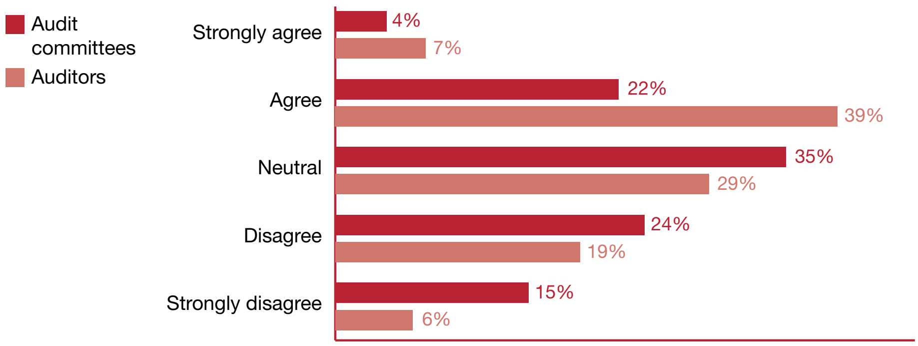
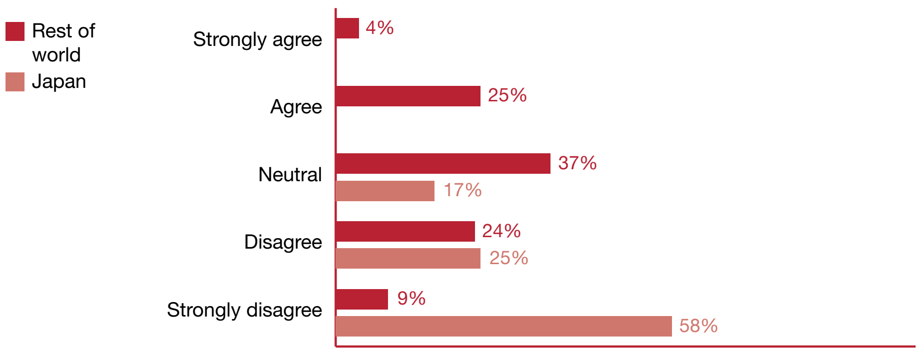


Figure 5: Are audit committees sufficiently independent of management?
Japan vs rest of world



The results for investment professionals in Japan are particularly striking, with over half (58%) of participants in Japan strongly disagreeing that audit committees are sufficiently independent. This may reflect recent high-profile local events, perhaps triggering a mood of general scepticism over the strength of corporate governance frameworks and particularly the independence of those responsible for oversight over the financial reporting process.

Very few of the investment professionals we talked to have had direct contact with audit committee members. This seems likely to be a reason for them to question the independence of audit committees from management. In our view, the lack of visibility of audit committee members within the investment community is undermining their credibility as the independent interface between shareholder and management. This presents an opportunity – through increasing audit committees' visibility and encouraging them to communicate with investors – to increase trust in the effectiveness of companies' governance frameworks.

Audit committee reports

'Expanding the audit report to cover the reasonableness and completeness of audit committee reports gives auditors responsibility and power to push back when audit committees are not giving the correct information. I think it's a really important dynamic to what goes on behind the veil.'

If many in the investment community do not perceive audit committees to be sufficiently independent of management, it should come as no surprise that audit committee reports are not routinely read by the investment professionals we spoke to – with the exception of those in the emerging markets and continental Europe. Over 50% of those we interviewed disagreed or strongly disagreed with the statement *'I always read the audit committee reports of the companies that I follow'*.

'However little I read the audit opinion, it doesn't compare with how little I read the audit committee reports.'

For some investment professionals, audit committee reports are issued too late to be useful. Some query the reliability and relevance of the information they provide, unsettled by doubts as to the true independence of audit committees from management.

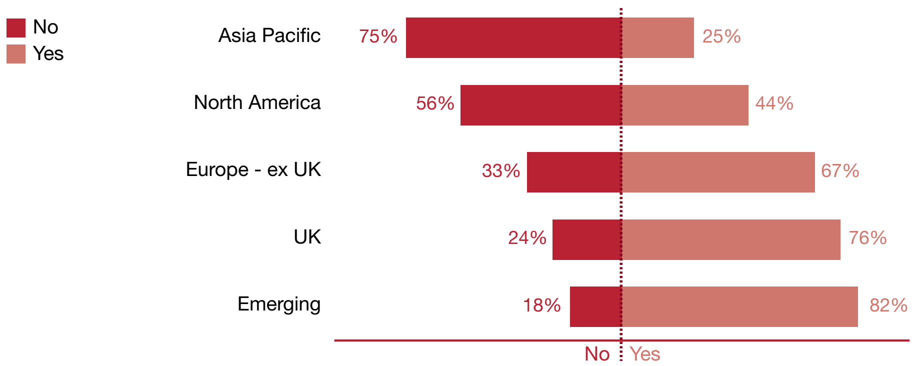
'I don't think of them [audit committee reports] as important because the timing of the release is late.'

Asked whether they would find it useful if auditors expanded their audit report to cover the completeness and reasonableness of audit committee reports, investment professionals' views vary considerably across different regions. The majority (75%) of investors and analysts in the Asia-Pacific region do not think this would be useful, while participants in North America are relatively evenly split. The strongest support for this idea comes from investment professionals in emerging markets and Europe. The level of interest expressed among investment professionals in the UK is of particular note, given the debate taking place in the UK about how audit committee reporting could be enhanced.

'I've been managing money for a decade and I'm not sure what an audit committee actually does.'

We interpret our survey findings as indicating a desire among investment professionals in many territories for greater trust in the governance of companies. There is a clear opportunity for this trust to be strengthened by improving investors' and analysts' understanding of the role of audit committees. This could be achieved in part through greater communication between the investment community and audit committees. Audit committees should consider raising their visibility and provide more informative reports to shareholders, perhaps including information (or, in some countries, better information) on their assessments of auditor performance and the basis for auditor reappointments. We also support the idea of a formal audit committee charter, setting out criteria for matters such as the appointment of auditors and the approval of non-audit services. Such adjustments, we believe, could enhance understanding of the corporate governance framework and deserve to be explored further.

Figure 6: If auditors expanded their audit report to cover the completeness and reasonableness of audit committee reports, would you find this useful?



'There are some jolly good audit committees and there are some really bad ones. Spotting the difference from our side is not always easy.'

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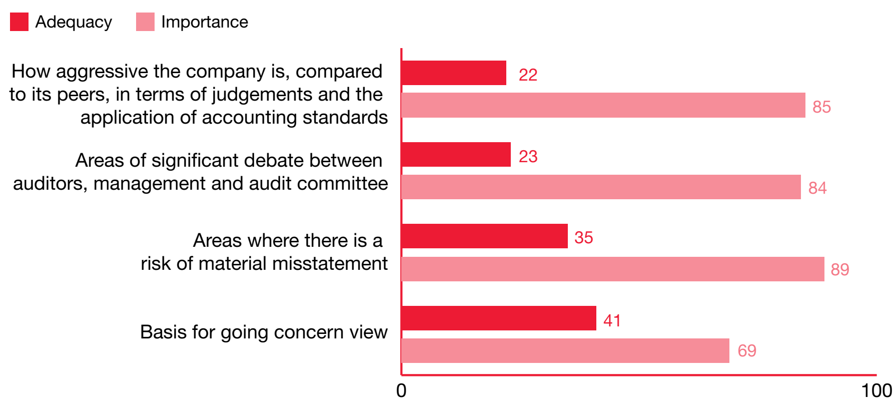
More value from today's audits

Most of the investment professionals we interviewed had an appetite for more insight about the company from today's audit. This is particularly marked among participants in emerging markets.

Despite their desire for more insight, these investors and analysts are aware of the practical challenges and potential unintended consequences around the audit profession's ability to deliver more added value through the audit opinion. Given the litigious nature of the modern business environment, for example, many participants questioned whether auditors' reports could be expanded in a way that would provide investors and analysts with real information and insights, as opposed to generating more boilerplate statements. This is an issue being debated in the US but is also a concern elsewhere.

Figure 7: How important are the potential disclosures listed below? How adequate is the information that you currently receive in each of these areas?
On a scale of 0 (not at all important/not at all adequate) to 100 (highly important/highly adequate)



Asked about the importance of specific disclosures that might be helpful in their company assessments, the investment professionals we surveyed would most like insight into the aggressiveness of a company's financial statements – the way judgement and accounting standards have been applied. The adequacy of current information provided on these areas is considered relatively low. However, some of those interviewed – while identifying the value of such insight – question the feasibility of defining or benchmarking 'aggressiveness' in practice.

'If they're pushing the envelope, you want to know about it. If they're pushing the envelope and technically you can't qualify, we don't find out.'

'It would be very helpful to know where people push the boundaries. If all companies could be ranked in terms of aggressiveness or conservative accounting policies, as judged by their auditors, that would be helpful information.'

'I'm wondering how one could actually report on the aggressiveness of the assumptions used without huge controversy and agreement.'

'If you don't have privacy you don't have honesty. And if you don't have honesty, nothing gets done properly.'

Members of the investment community we talked to also place importance on information about areas of significant debate between auditors, management and the audit committee. However, some participants – particularly in the UK – express concerns that there might be practical difficulties in increasing transparency in this area without also reducing the willingness of all parties to engage in frank debate. They are concerned that levels of openness and honesty in those discussions could be reduced. These opinions may reflect the debate in the UK, stimulated by the Financial Reporting Council's consultation, on ways to encourage more meaningful audit committee reporting.

'As an analyst, I am really interested in this area. At the same time, I am doubtful about how much both the company and the auditor can disclose.'

'A bit like the family's dirty linen, it might genuinely be better for you if you don't know. There has to be a level of confidentiality and a level of privacy of discussion.'

The investment professionals we interviewed also place high importance on information about areas where there is risk of material misstatement. They appreciate that principles-based standards require the application of judgement and that differing judgements could result in quite different financial statement outcomes.

'It would be fantastic for analysts to see areas of critical debate or areas where there are real risks of material misstatements with some sense of quantification.'

'With a principle-based accounting standard, the role and impact of 'management judgement' becomes much higher; therefore, qualitative insights into such judgements are quite important. This judgement process is currently a black box.'

Going concern

'I think that all key financial covenants need to be disclosed. There's also a lack of disclosure about where the liabilities are.'

The investment professionals we interviewed are relatively content with the information available to them on going concern, particularly in relation to large cap companies and those operating in mature markets. But they see room for improvement, with some of those we interviewed calling for greater disclosure of covenant information. Looking at regional variations, Japanese participants have a much stronger appetite for clearer explanations of the basis for going concern assessments, very likely a reflection of the high-profile difficulties within some local entities.

'In times like this, a large part of our job is looking at covenants and what risk factors could cause them to fail.'

'For larger companies, going concern is almost a given. For smaller companies, depending on where they are in their lifecycle, I would like more information on how they have concluded that they are a going concern.'

'Auditors are too scared to give an opinion that might affect the company in a going concern sense.'

Finding workable solutions

Our survey reveals the tension that many investment professionals identify between their desire for increased insight into aspects of the audit process, and their concerns over both practical difficulties and the risk of negative or unintended consequences.

In particular, a number of participants question how the value and relevance of the audit could be enhanced without inadvertently causing harm.

In our view, any approach to answering this question must take a holistic view of audit within the context of the overall governance framework. This includes considering the range of potential sources of information and insights that investment professionals seek, and the various channels they might use to get them.

Where, how and by whom greater insight into the audit process could be provided is still very much to be debated so that optimal solutions for the capital markets as a whole can be found. Lessons could perhaps be learnt from the audit reports prepared in India and France and the additional areas of focus they contain.

In our view, auditors should not be an original source of factual data or information about the entities they audit. This is one of the principles that should drive the discussion about additional disclosures.

Management is best placed to provide some of the additional information and insights that our survey shows investment professionals value. Improved disclosures from management on covenant information, for example, would be well received.

Audit committees also have a role – being the most appropriate source of information for specific matters, such as areas of significant debate with the auditor. This is a particularly strongly held view among commentators in the UK, including the Financial Reporting Council, but one that is increasingly gaining currency in other jurisdictions.

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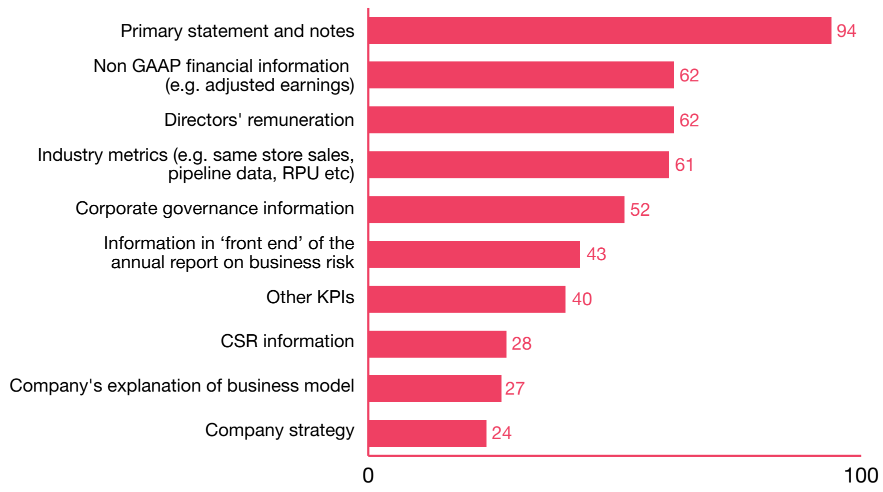
Assurance tomorrow

'Anything that is driving an investment decision or share price should be given a high level of assurance.'

Varying levels of assurance can be provided over reported information. Audit, for example, provides a high level of assurance for financial statements today. Auditor involvement can be and is provided for other types of information and reporting too – for example, reading the narrative sections in the annual report for consistency with the information in the financial statements.

Our survey sought to establish the levels of assurance investment professionals would like to see applied to a range of information types, if given a free choice.

Figure 8: What level of assurance would you like to see for the following types of information?
On a scale of 0 (no assurance) to 100 (very high level of assurance)

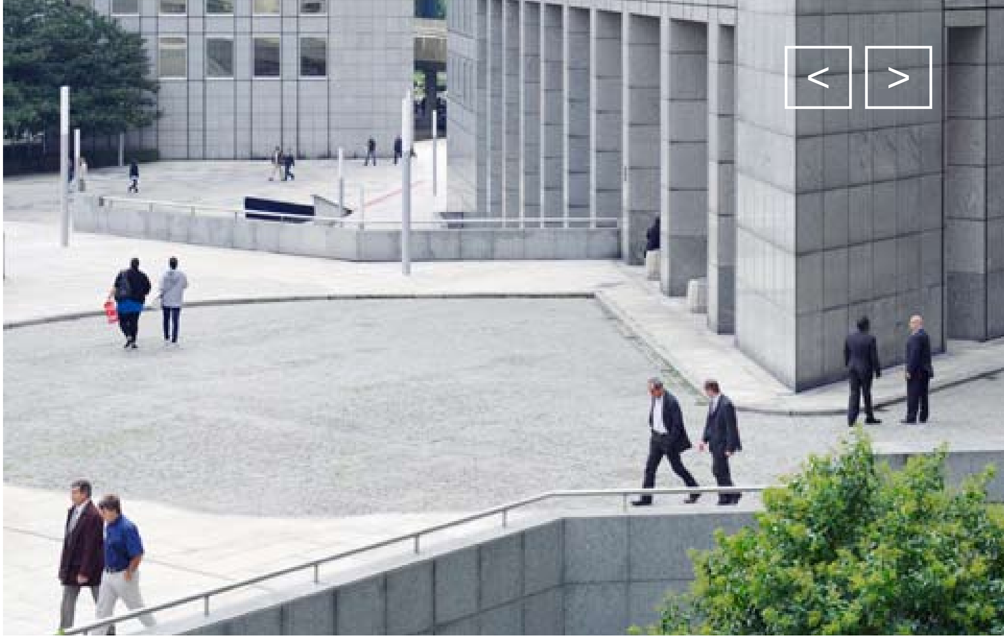


The vast majority of interviewees want the highest level of assurance to continue for the primary financial statements and accompanying notes, but the level of assurance desired for other areas varies significantly. Three broad categories for consideration emerge:

- Corporate governance (including directors' remuneration);
- Quantitative performance measures (primary statements and notes, non-GAAP financial information and industry metrics); and
- Annual report 'front end' and strategic matters (business risk, other KPIs, explanation of the business model and company strategy).

A strong theme that emerges is the desire by the investment professionals we talked to for a higher level of assurance over the metrics that move markets.

'Auditors need to understand investors better. We are looking for assurance on information that helps us to understand the business.'



Corporate governance

'If this [CSR] information is related to financial value, assurance would be useful.'

When it comes to the reporting of corporate governance matters, survey participants express strong support for robust assurance over directors' remuneration reports.

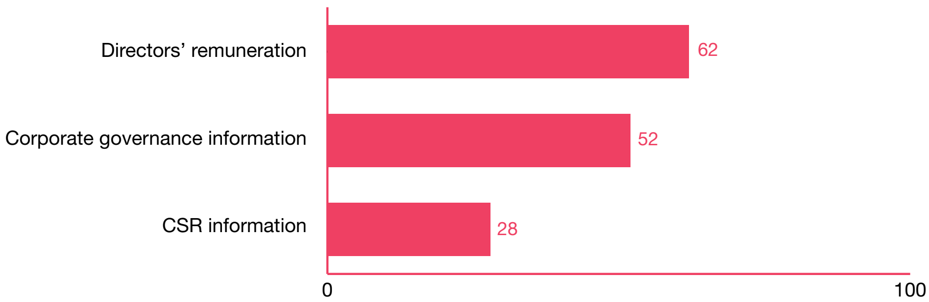
There is less appetite for more than a consistency check on reported information relating to the more general corporate governance area, a view that comes through particularly among participants in the UK, where rather unique corporate governance arrangements have developed, which appear to work in the UK market.

With the exception of participants in the emerging markets, we find little appetite for a high level of assurance over CSR information, unless it is relevant to the company's valuation.

'Investors aren't really looking for an auditor's view on the social responsibility or environmental responsibility of a company.'

The level of interest in a high level of assurance on CSR data among participants in emerging markets may reflect the fact that these territories have had experience of poor environmental or ethical standards.

Figure 9: Level of assurance desired over governance information
On a scale of 0 (no assurance) to 100 (very high level of assurance)

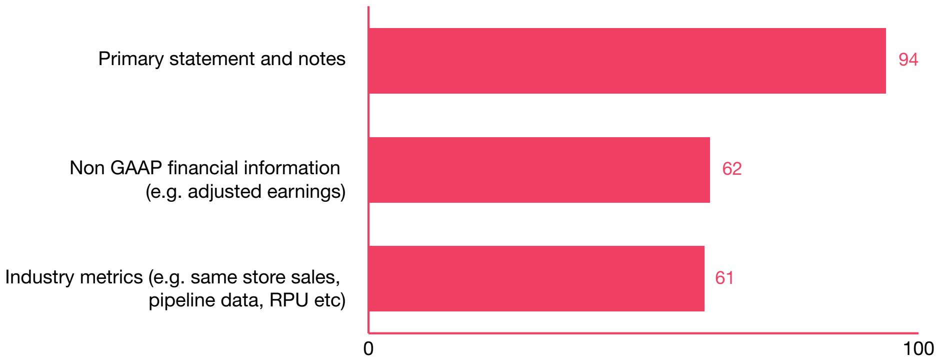


Quantitative performance measures

The highest level of assurance is generally required for the primary financial statements and accompanying notes. There is also strong support among survey participants for robust assurance over non-GAAP financial information (such as adjusted earnings) that is used for building economic models, which in turn drive investment actions that move markets.

'Any financial information should be audited.'

Figure 10: Level of assurance desired over 'performance' information
On a scale of 0 (no assurance) to 100 (very high level of assurance)



'Our team would like to see all of the [non-GAAP] adjustments audited.'

The investment professionals we interviewed look favourably on the provision of robust assurance over industry-specific metrics (such as same-store sales, pipeline data and revenue per user). They say that the reliability of this data is important because of its relevance to investment professionals when analysing company performance.

'We rely primarily on unaudited information, and it would be preferable if it was audited. You'd have more confidence in it and management would have less discretion.'

'What I want the auditors to tell me is; 'Yes, they actually did calculate it the way they told you they were calculating it'. That's their real value to me.'

Those interviewed recognise that the ability for assurance to be provided in these areas requires standard definitions or ground rules for data compilation.

'They should be assured with industry standards applied.'

Again, our discussions highlighted investment professionals' understanding of the potential for unintended consequences of mandating assurance over non-GAAP or industry-specific metrics, fearing that such requirements might reduce the volume of disclosure – unassured data is better than none.

From an auditor's perspective, the lack of agreed, uniform standards for non-GAAP and industry-specific data is a significant practical constraint in assuring such information. However, this is an area where companies can take a lead. Previous surveys conducted by PwC have identified some ground rules that investment professionals would like to see applied to non-GAAP and industry-specific metrics. Companies that adhere to these standards of reporting today might consider having their statement assured to that effect, potentially enhancing the credibility of their reported information with the investment community.

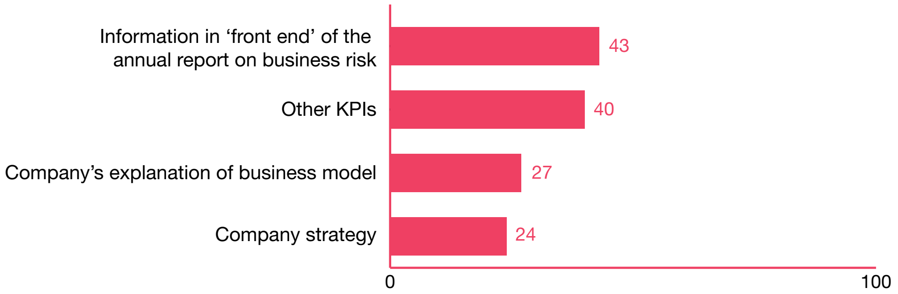
'I want assurance over non-GAAP profits. I need to be able to peel back the spin and get to the truth'.

'You wouldn't want it to develop into a situation where, because it was audited, you were just getting less disclosure.'

‘Front end’ and strategic matters

With the exception of the investment professionals we spoke to from the emerging markets and continental Europe, there is little appetite for a high level of assurance over the broader contextual information provided by management.

Figure 11: Level of assurance desired over 'front end' information
On a scale of 0 (no assurance) to 100 (very high level of assurance)



Many of the investment professionals we spoke to said they expect auditors to highlight to shareholders anything they become aware of that is factually incorrect in management’s statement of business risk provided in the annual report, or in the reported KPIs related to human capital, customer satisfaction or similar ‘other KPIs’. Few see a need for a high level of assurance over such information, although there are a small number of investment professionals who see some value in audit activity over such areas.

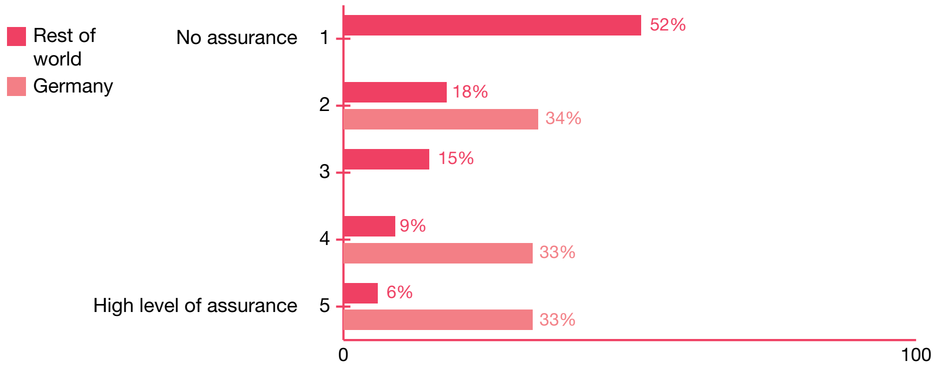
There is even less desire among the investment professionals we interviewed for a high level of assurance over the company’s articulation of its business model or its strategy. This is generally not seen as part of the auditor’s role.

'If the preparer is a conglomerate, I imagine both the company and auditor would drown in the extra work required [for business model assurance].'

Germany stands out from the rest of the world. The investment professionals we interviewed there are more likely to see value in higher levels of assurance on a company's explanation of its business model and its strategy. This may reflect the particular nature of corporate reporting in Germany, such as the long-form report prepared for the supervisory board, which contains information such as management's assessment of the group's economic situation, and nature and scope of the audit. Germany appears to have developed a culture supportive of the reporting of broader contextual information, with the result that higher levels of assurance on that reported information are more widely valued.

'As investors it is up to us to form a view of whether the strategy is right or wrong. Your and my ability to audit the strategy is probably not that different.'

Figure 12: What level of assurance do you need over a company's reporting of their business model?
Germany vs rest of world
On a scale of 1 to 5 where 1 = no assurance; 5 = high level of assurance



Different information channels require differing assurance

'Earnings releases are unaudited: and that doesn't seem sensible for the profession or for the interaction between companies and shareholders.'

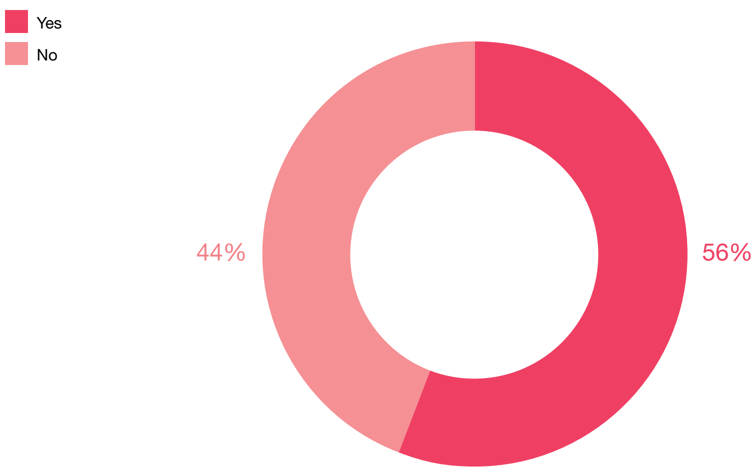
Investment professionals receive information through a range of channels, but they don't necessarily see a need for assurance over all of them.

Nearly all those interviewed (97%) want assurance over the financial statements but they also expressed an appetite for earning releases (preliminary statements) to include an assurance report, 56% saying there should be assurance over information reported in earning releases.

'Earnings releases should be audited. I have seen cases where the annual report was different from the prelim and it was a disaster'.

Based on our interviews with investment professionals, we sense some confusion in the capital markets about the level of review or assurance applied to earnings releases. Investors and analysts do not always fully appreciate that this information is typically unaudited. Our research also finds that investment professionals interpret any revision of figures presented in earnings releases as giving a highly negative signal about the quality of management's controls and processes. This is the flipside of our theory that where companies issue audited year-end reports quickly, investment professionals assume their controls are strong.

Figure 13: Should there be assurance over the information presented in the earnings releases?



For some members of the investment community, the negative signal that accompanies a revision of figures presented in earnings releases appears to provide a form of sanction that gives them confidence in the numbers reported – even if there is no accompanying formal assurance statement.

Not surprisingly, it is noticeable that among those investment professionals who have experienced an investee company revising its preliminary information, appetite is particularly strong for earnings releases to include a formal assurance report. How such a need might be met would require further thought. While in some capital markets certain work is already done, its scope would need to be reassessed were it to lead to a formal report.

From a global perspective, there is less appetite among the investment professionals we interviewed for formal assurance over information provided through other channels such as investor presentations, annual general meetings (AGMs) or websites. Those we interviewed like the idea of investment presentations being 'an unfettered sort of place' and fear that they would happen less frequently if assurance was required over their content.

'I think there will be a huge drop in the number of investor presentations if [they were assured].'

'The assumption is that the presentation is consistent with the preliminary statement.'

Nevertheless, participants in emerging markets stand out from the rest, being particularly keen for investor presentations and the AGM to include an assurance report. As highlighted elsewhere in this report, investment professionals in emerging markets generally have a higher appetite for assurance than their peers elsewhere.

'The default presumption is that no company worth its salt would release a preliminary statement unless they were comfortable that there are not going to be restatements further down the track.'

Dialogue between auditor and investor

The majority of investors and analysts we talked to express a strong desire for auditors to become more visible in the investment community. This reflects in part an eagerness for improving understanding of what an auditor does – and doesn't – do.

'There has to be an education as to what auditors actually really do.'

'We need to see direct dialogue with auditors. Not necessarily to talk about company specifics but to talk about the role of the auditor and to better explain what an auditor does.'

Many investment professionals are also keen to gain the auditors' insight into where in the financial statements, on an industry-by-industry basis, the key areas of judgement lie.

'If you had a meeting at which the auditors could talk about areas of risk, discussions with management over the assumptions, and so forth, I think that would be a great area for improving the whole level of satisfaction with auditing.'

Some also see enhanced contact with auditors as providing investment professionals with a useful medium for signalling where they would value additional disclosure in financial statements. This would need careful consideration to avoid any negative unintended consequences.

As a network, we are proud of the efforts of our member firms to engage with investment professionals. Nevertheless, the findings in this survey indicate that there is a long way to go. We are committed to working even harder to strengthen channels of communication with the investment community, to improve understanding of our respective challenges, and enhance the robustness of the corporate governance frameworks and standards.

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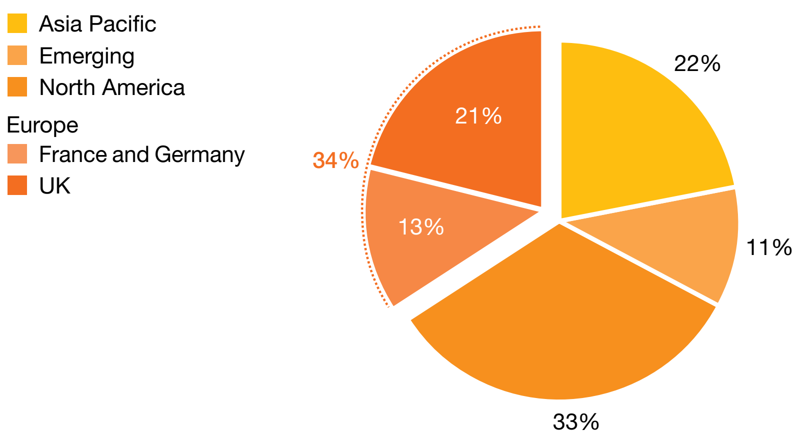
Appendix
Survey sample

Survey sample

The findings in this report are based on interviews conducted with 104 investment professionals located in 11 countries across the world. We have analysed the results within the following four categories:

- Asia Pacific (Australia, Hong Kong, Japan and New Zealand)
- North America (Canada and US)
- Emerging markets (Brazil and India)
- Europe (France, Germany and UK).

By territory



Buy-side, sell-side and credit analysts are all represented. The majority are equity focused, but fixed-income specialists and generalists, who look at both fixed income and equity stocks are also included.

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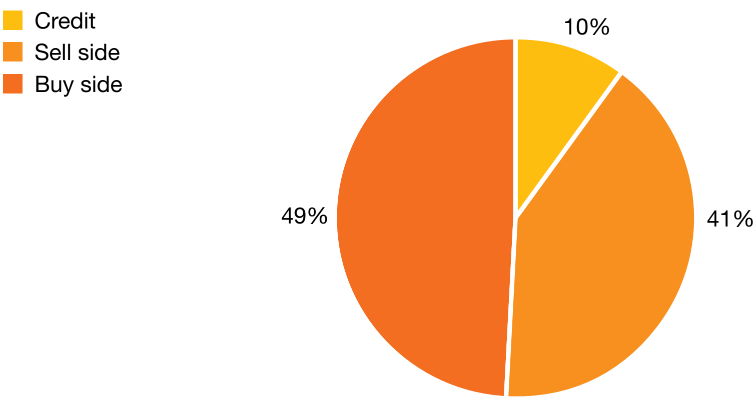
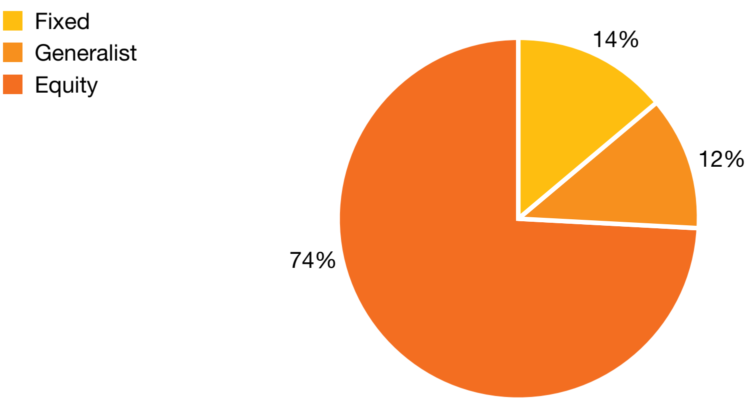
By type



By specialism



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