Investor view

Insights from the investment community

Issue 5 - What should an audit cover?

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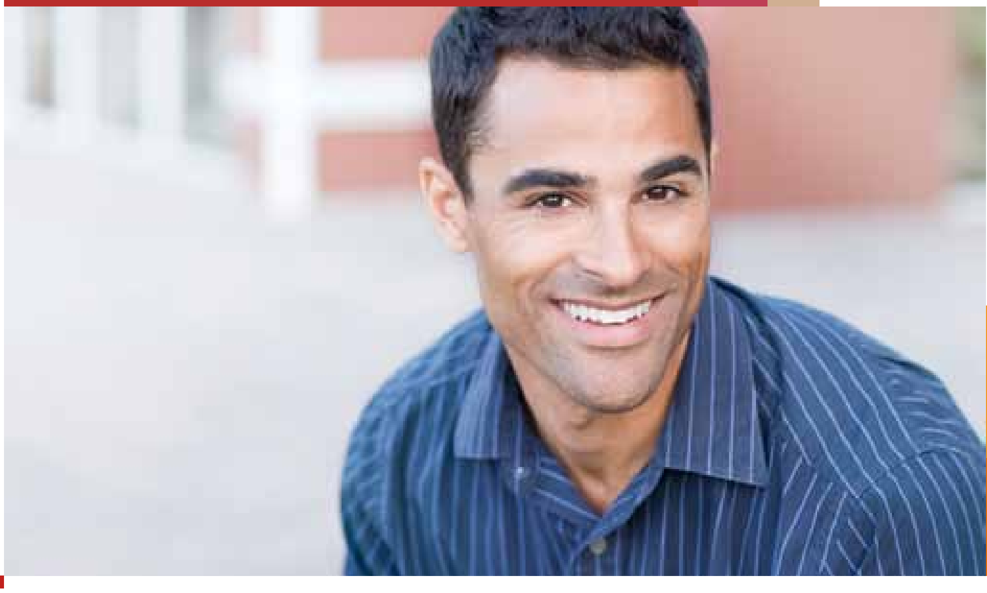

Changes investors would like to see in an audit

We asked investment professionals, including corporate governance specialists, for their views on how well audit currently serves their needs and how it might evolve in future. This 'investor view' highlights some of the key findings.

Do investors value the audit?

The 22 investment professionals who participated in this study clearly value having access to audited data. Most would be unlikely to consider investing in an entity if the audit report indicated that the accounts were not true and fair.

However, although investors rely on the audit process to gain comfort on an entity's reported numbers, this does not mean that they typically spend time scrutinising the auditor's report. The generic format that governs the structure of the audit opinion means that it rarely contains unexpected nuggets of information.

Are there opportunities to enhance the value offered by the audit? The suggestions offered by the participants in this study fall into four categories:

- Consider the timeliness of the audit report;
- Lift the veil on today's audit;
- Assure the metrics that move markets;
- Talk more!

Timeliness

While all those interviewed want the annual document of record (for example, the annual report) to carry an auditor's report, they have a strong desire to know that the data presented in the preliminary announcements (prelims) is equally reliable.

The information presented in prelims is used to update analysts' models on entities: it frequently moves share prices. The majority of those interviewed assume that management would not release data in prelims that had not been 'signed off' by the auditor; and ideally they would like it made explicit where this is the case. They would therefore like to see a formal statement of assurance being attached to such documents.

Lifting the veil

Respondents said they don't get adequate information about elements of the audit process. They want to know more – either through more detailed audit committee reporting or from the auditors – about three key reporting areas:

- risk of material misstatement;
- aggressiveness of judgements and application of accounting standards; and
- areas of significant debate between auditors, management and audit committees.

Governance specialists were also keen to learn more about the assumptions underpinning the going concern judgement.

However, those interviewed recognise that there is a difference between the ideal reporting scenario and what is realistically achievable. Many expressed concern that expanding reporting could reduce the likelihood of open and honest discussions between the auditor, management and audit committees, with a risk of inadvertently damaging audit quality.

Assuring the metrics that matter

Many of those we interviewed expressed frustration that the audit opinion does not cover all the metrics that lie at the heart of management's communication of performance – and that move the capital markets.

All those interviewed want the highest possible level of assurance to continue for the primary financial statements and notes, and there was also demand for non-GAAP measures (such as 'adjusted' or 'core' earnings and for industry-specific metrics (such as 'same store sales' or 'revenue per user') to be subject to a high level of assurance.

With the exception of risk reporting and directors' remuneration — where there was some appetite for assurance by auditors — the mainstream investment professionals and corporate governance specialists interviewed showed little appetite for high levels of assurance over other areas of the annual document of record, including strategy statements, other (that is, non-industry-specific) KPIs, the governance report, the business model and CSR data.

Talk more!

It appears that investors don't often come into contact with either auditors or audit committee chairs. Many of those interviewed believe that this is a missed opportunity and expressed a desire for more open channels of communication. Suggestions raised include:

- periodic meetings between auditors, audit committee chairs and shareholders;
- investors having direct access to the auditor;
- individual shareholders being able to have conversations with the auditor and audit committee;
- auditors offering 'teach-ins' on the audit process to understand the scope of the audit.

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