



AUDIT &
ASSURANCE
FACULTY

Where next with assurance?

THE JOURNEY: MILESTONE 5



Where next with assurance?

The Journey Milestone 5

Chartered accountants help businesses achieve their aims, meet the needs of their stakeholders, and participate in an economy that is strong and resilient both now and in the future.

'Information is central to all businesses. It underpins why a business exists, what it does and how it provides value to counterparties. Information enables a business to communicate value propositions to potential counterparties and understand their needs. It enables a business to coordinate activities across different counterparties and thereby deliver value to all of them. Information also supports organisational knowledge and the ability to codify and share learning across a business or with counterparties.'

Measuring IT Returns, IT Faculty, ICAEW, December 2008

Assurance is the art and science of generating trust in information. Digitisation is an information revolution on a par with the introduction of the printing press or even the invention of paper. The way we create and use information will never be the same again. It should not be surprising that the old model for assuring business information, the audit of the annual financial statements, is not always sufficient to meet the needs of organisations and their stakeholders.

This thought leadership paper continues ICAEW's series, *The journey*, with a review of the current state of the assurance debate and a series of propositions on where, and how, assurance should be taken next.

We think that...

- Rather than focusing on the annual report – or any other single report of an organisation – we should think about the right way to use assurance to meet the needs of the organisation itself.
- The role of the board in determining the need for assurance, internally and externally, is vital to understanding the future of assurance.
- Getting the right assurance in the right place is essential. This means asking the right questions about risks and information flows, and in a complex organisation it means keeping track of the situation with an assurance map.
- Assurance can be provided over risk disclosures or forward-looking information, even if the question asked is different from 'is this true and fair?'
- Assurance can add value to narrative information using current principles and techniques, and the skilled judgement of preparers and assurance providers.

What do you think?

This is a consultation paper. Whether you are interested in assurance as a provider, as a preparer of information, as a regulator, or as a user of business information we are keen to hear what you think of the five statements above. Please send comments to ruth.ward@icaew.com or via icaew.com/assurancewherenext by 22 July 2016.

*Please note that your comments may be quoted in future ICAEW publications on assurance and corporate reporting. If you wish to have your response kept anonymous, please let us know.

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The journey so far

When ICAEW published [The journey: assuring all of the annual report?](#) in 2013 there was increasing demand for assurance from external providers, particularly in the form of private assurance reports for the audit committee and in sustainability assurance.

Since we published [The journey](#) the assurance market has continued to expand. We have collected case studies of real assurance engagements to share what is happening, and continued to work with experts in the field to share their technical experience.

Milestones on the assurance journey

Short papers tackling tricky topics.

- [Milestone 1: assurance over key performance indicators](#)
- [Milestone 2: assurance over risk disclosures](#)
- [Milestone 3: assuring the appropriateness of business information](#)
- [Milestone 4: assuring materiality in narrative reporting](#)

Assurance case studies

Making the transition to assurance

Following audit threshold changes Reeves & Co worked with BSL Gas Technologies Ltd, as it made the change from statutory audit to independent assurance report.

[Read more.](#)

PwC helps EDF to spread the word about green energy tariffs

When looking for a way to communicate how it was meeting its promise to provide low-carbon electricity to its customers, EDF Energy plc approached PwC to deliver straightforward assurance reporting.

[Read more.](#)

KPMG assures KPIs for Channel 4

Insights from KPMG on its work with Channel 4 to provide limited independent assurance on the television company's Statement of Media Content Policy.

[Read more.](#)

Independently assured financial statements

When door hardware distributor Relcross was no longer subject to statutory audit it approached James Cowper LLP to assure its financial statements, providing independent credibility and an additional level of comfort for the firm's shareholders.

[Read more.](#)

Innovating in human rights assurance

Mazars LLP provides insight into how it approaches due diligence for human rights reporting, discussing its work with India-based steel manufacturer Jindal Stainless Ltd.

[Read more.](#)

The business as a whole

Rather than focusing on the annual report – or any other single report of an organisation – we should think about the right way to use assurance to meet the needs of the organisation itself.

What do you think?

Changes in corporate reporting

In *The journey* we used the annual report – currently a compendium of information, opinions, and data arranged alongside the annual financial statements – as the focus for a broader discussion about the challenges and opportunities for assurance over non-financial information.

The current model of the annual report originated at a time when the amount of information that a company could publish was limited. Modern IT has transformed how business information is gathered, used internally, and shared externally. The practical impact of those changes is still being worked out, and there is no guarantee that the annual report will retain its importance in 20 or 30 years' time.

Integrated reporting

The idea of a single report is still central to the ongoing debate about corporate reporting. One example is the integrated report (IR) proposed in 2013 by the International Integrated Reporting Council (IIRC) in their *International integrated reporting framework*.

Integrated reporting, in the IIRC's sense, depends on and reflects integrated thinking within an organisation. In practice many organisations have embraced the idea of integrated reporting but this has not always reflected the integrated thinking envisioned by the IIRC Framework. For example, in July 2015 the IIRC reported that **more than one-third of Dutch listed companies were working towards integrated reporting**, but only six of those companies were doing so using the IIRC Framework. Others describing their reports as integrated may only have meant that they incorporated their sustainability report into their annual report.¹

'Core and more'

The Federation of European Accountants (FEE) tackled a different aspect of corporate reporting late in 2015, with a suggested approach described as 'core and more'.² FEE suggest a 'core' element to corporate reporting which acts as an executive summary, with hyperlinks taking readers on to a selection of 'more' elements which expand on particular details. 'Core and more' still involves one main report, but the 'more' elements expand this towards a layered approach.

Pragmatic thinking

Another approach to changes in corporate reporting is pragmatic, recognising that innovation needs to develop in practice rather than in theory. ICAEW's recent paper, *Audit insights: corporate reporting* takes this perspective and raises seven questions to support better reporting now and in the future.

The example of financial statement audit might tempt us to develop an equivalent assurance engagement, whether tailored to the annual report as it is now, to the proposed integrated report or to 'core and more' report(s). Doing so could be a mistake when the future of corporate reporting remains unclear.

Seeing the business as a whole

There is another reason why focusing on a specific assurance engagement would be a mistake. The financial statement audit did not spring fully formed from the forehead of some Victorian accounting Zeus. It was developed in an unregulated market, and took shape as accountants innovated to meet the needs of organisations and those organisations' stakeholders.

Conclusion

To develop assurance services in the 21st century, accountants once more need to innovate and apply their skills to meet business needs. That means seeing the business as a whole, and learning what those needs are. Assurance that addresses the needs of the whole business will do most to align organisations priorities with those of their stakeholders.

¹ For example, see [Bayer's online archive of reports](#), describing the merging of the annual and sustainability reports as integrated reporting.

² *The Future of Corporate Reporting – creating the dynamics for change*, FEE, October 2015

The role of those in charge

The role of the board in determining the need for assurance, internally and externally, is vital to understanding the future of assurance.

What do you think?

Different kinds of organisations in different contexts have different management structures. Throughout this paper we have used 'directors' and 'the board' as a shorthand for 'those in charge'. Anybody with the power and the responsibility to control an organisation, however large or small, would be in the same position to determine its need for assurance.

Investor demand?

Early in 2016 the Institute of Chartered Accountants of Scotland (ICAS) published research which, among other things, asked auditors and their clients about the demand for assurance over the annual report. They found 'little perceived investor demand'. Even the partner who was most positive on assurance acknowledged that: 'It is not clear that there is an appetite ... investors may think that we are doing it anyway.'³

On the other hand, in 2013 we observed that assurance engagements over non-financial information were taking place, and concluded that there must be demand for this work. If there was no demand for assurance we would not see ongoing activity in the assurance market.

What should be made of this apparent contradiction? It is likely that the answer is simple: investors want confidence in information, but they are not interested in how that confidence is achieved. Board members, seeking comfort that they have met the needs of investors, are the people who specify when and where assurance should be obtained.

In other words, it is the board that translates investors' need for confidence into a demand for assurance.

A dual role for directors

Directors routinely rely on information prepared by others internally, and are ultimately held responsible for the ways in which an organisation impacts the world around it. Moreover, directors are best placed to identify assurance needs in the context of the whole organisation, and to determine how they can best be met.

Every assurance engagement involves at least three parties: the preparer of the information, the user of the information and the assurance provider. Perhaps because of the influence of decades of financial statement audits, directors have generally been seen as preparers rather than users of information when they are in fact both.

Understanding the business

Businesses run on information flows, internal and external. Modern technology hasn't changed that, but it has vastly increased the amount of information involved and it has changed the ways in which it is created, shared and used. The modern assurance market has not yet developed enough experience to have a known set of best practice engagements, apart from in a few specific and regulated areas. For now, the needs of each business must be established independently.

The people with the best understanding of any business should be those sitting on the board.

Conclusion

Directors are best placed to determine where assurance is needed for three reasons: they are the interpreters of stakeholder demand; they are both the preparers and the users of business information; and they have the best understanding of the business.

Assurance providers thinking about what's best for a business will always have to consider the needs of all its stakeholders. Any discussion of the future of assurance which does not involve directors will struggle to understand where the demand for assurance is coming from, and will have difficulty identifying where assurance engagements can add the most value for everyone.

³ Fair, balanced and understandable: enhancing corporate reporting and assurance?, Ian Fraser and Boram Lee, ICAS, January 2016, p.72.

The right assurance in the right place

Getting the right assurance in the right place is essential. This means asking the right questions about risks and information flows, and in a complex organisation it means keeping track of the situation with an assurance map.

What do you think?

Assurance alternatives

Assurance adds credibility to information, and thus mitigates risks associated with bad information – the risk of relying on it to make decisions internally and the risk of publishing it externally.

There are many different ways to get comfort over a piece of information. Sometimes simply having the right systems in place will do it. In other cases, internal audit needs to carry out a regular review. Sometimes the risk can be outsourced or insured away. Sometimes, an independent external assurance provider will be needed.

Mapping the situation

The trick is to get the right kind of assurance lined up against each risk. Since assurance is about building trust in information, the first step is working out where there are risks associated with information flows. The next step is asking what is already in place, if anything, and whether it is sufficient. Once directors have identified the places where they need to be sure of the quality of the information at hand, they can consider how best to get assurance.

In more complicated organisations this process is often already documented into a formal assurance map, showing the information risks across the organisation, the relevant information flows, and what has been done in each case to mitigate risk. If a business has an internal audit department they are likely to be the people carrying out this work, as it helps identify where they can provide assurance and where an external provider should be called in.

Risks and information flows

Assurance is most useful in the places where significant risks and information flows sit together. Identifying these places can be done by asking two different questions:

- What are my main risks?
- What are my main information flows?

The first question highlights those risks that have already been identified. For example, a cybersecurity risk that is already a key concern to those running the business. If there is any associated information flow – such as a monthly management review of performance against a target – then there is scope for assurance to add credibility to that information and reassure management.

The second question highlights those information flows that are significant, but may not have been identified as high risk. For example, the business is required by a regulator to report an industry-specific KPI every year. An inaccurate report would be a very visible mistake, so it would be worth weighing up the risk and considering whether this is a place where assurance could add value.

An iterative, ongoing process of thinking about both risks and information flows will give those running a business the best perspective to map out its assurance needs.

Conclusion

Independent assurance engagements, such as the financial statement audit, may provide the highest level of credibility but they are only one part of the picture. Different approaches suit different risks and information flows.

Maintaining an assurance map, updated regularly with reference both to risks and information flows, is the simplest way of planning and documenting the use of assurance across a complex organisation.

What about risk disclosures and forward-looking information?

Assurance can add value to risk disclosures or forward-looking information, even if the question asked is different from 'is this true and fair?'

What do you think?

Unknowable accuracy

ICAEW's Information for Better Markets Initiative commented, in its paper *Reporting business risks*, that: 'It is impossible to know even after the event whether most qualitative, and some quantitative, risk reporting is accurate or inaccurate. This must limit the reliance that users can place on it.'⁴

Forward-looking information, like risk reporting, is an area where the only real test for accuracy is the test of time. How can assurance add value to something that defies categorisation as accurate or inaccurate?

The answer is that accuracy is not the only feature of these kinds of information. Both risk reporting and forward-looking information can be prepared well or badly, and can be more or less useful for decision making, based on things that can be known at the time they are prepared.

Process assurance

Milestone 2: assurance over risk disclosures draws on experience regarding similar kinds of information, such as control environments, and suggests assurance over a company's risk reporting process rather than the output of that process.

A framework for reporting could be devised either internally (and assessed by the practitioner for suitability) or externally (for example by a regulator). Once this has been done, an assurance report can consider whether the process has been implemented as described.

The same approach could be applied to forward-looking information, providing comfort that predictions had been made according to a sensible process. This is discussed in more detail in ICAEW's *Prospective financial information: guidance for UK directors*, published in 2003 and currently being updated.

Usefulness

ICAEW's guidance on prospective financial information states that to be useful, it should be understandable, relevant, reliable and comparable. Understanding the usefulness of either forward-looking information or risk reporting could be valuable to people making decisions based on that information.

An assurance provider can carry out an engagement to provide an opinion on whether information that cannot be assessed yet for accuracy has the four characteristics for usefulness.

Conclusion

An assurance engagement can be used to build confidence in information that has unknowable accuracy, as long as there is some way in which that information could be better or worse from the perspective of decision-makers.

An assurance engagement on these subjects might consider whether the information is useful, or whether the process has been implemented as described, rather than asking 'is this true and fair?'

⁴ *Reporting business risks*, ICAEW, 2011, p.iii.

What about narrative information?

Assurance can add value to narrative information using current principles and techniques, and the skilled judgement of preparers and assurance providers.

What do you think?

Fair, balanced and understandable

Late in 2012 the UK's Financial Reporting Council introduced the requirement that directors make a statement to the effect that: 'They consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.'⁵

In practice all but two FTSE 350 companies now include a 'fair, balanced and understandable' statement, though two-thirds give little or no further information.⁶ The auditors of these companies are required to report any inconsistency they discover between the directors' statement and what they have found during their routine work on the financial statement audit.

Research commissioned by the ICAS found that the level of work carried out by auditors varies, as does the level of assurance that they believe has been provided.⁷ ICAS also found a range of perspectives on what 'fair', 'balanced', and 'understandable' mean, with different members of the same company or audit firm expressing different views.

Reporting by exception, without having to carry out any more work than would be done during a routine financial statement audit, should not be expected to provide much assurance. Despite this, and despite different views on what was being done, respondents agreed that the requirement adds value.

Completeness in narrative information

The IIRC, in its 2014 paper *Assurance on <IR>*, emphasises that the responsibility for ensuring that the contents of a narrative report are complete lies with those preparing the report. Once the preparer can articulate what should and shouldn't be disclosed in clear reporting criteria, an assurance provider can assess those criteria and whether or not they have been followed.

Existing assurance principles, as set out in the *International framework for assurance engagements* developed by the International Auditing and Assurance Standards Board (IAASB), support this approach. ICAEW's paper *Milestone 3: assuring the appropriateness of business information* uses key performance indicators to show what can be done on non-financial information.

The same approach could be used for assurance over narrative information. The ambiguity of narrative would require the assurance provider to use their judgement, but it should be noted that much financial information is a matter of judgement – valuations, for example.

Materiality: what matters?

For those preparing narrative information, the stakeholder engagement model developed by the Global Reporting Initiative (GRI) promotes a materiality analysis that takes into account the needs of businesses and their investors. The GRI has found that this produces consistent results across different organisations.⁸ Although developed with sustainability in mind, the same principles can be applied to any collection and publication of business information.

5 UK Corporate Governance Code, Financial Reporting Council, p.30.

6 Trust and integrity – loud and clear?, GrantThornton, December 2015.

7 Fair, balanced and understandable: enhancing corporate reporting and assurance?, Ian Fraser and Boram Lee, ICAS, January 2016.

8 Defining Materiality: What Matters to Reporters and Investors, RobecoSAM and GRI, 2015.

Assurance providers need their own approach to determining materiality, as they must assess whether the preparers have got it right. Drawing on developing practice, ICAEW's *Milestone 4: assuring materiality in narrative reporting* suggests five materiality factors for assurance providers to consider which could mislead a user of narrative information. They are:

- omission of facts;
- misstatement of facts;
- misrepresentation of trends;
- bias in description of position or facts; and
- unsubstantiated claims.

Conclusion

The enthusiasm that ICAS found for the UK requirement for reporting by exception on the 'fair, balanced and understandable' statement suggests that assurance over narrative information could be popular. However, the lack of agreement about what reporting by exception should mean in practice could undermine the value of this work.

The inherent ambiguity of narrative need not be a barrier to assurance under existing assurance principles. That ambiguity needs the kind of considered judgement that assurance providers already apply to some financial information, such as valuations. Further guidance, such as the ICAEW materiality factors, can be drawn from the experience of those carrying out these engagements.

Where next?

Assurance is more than just audit, and it is more than just external assurance reporting. Organisations benefit when they get the right kind of assurance in the right place, mitigating risks, improving the reliability of information and building credibility with stakeholders.

We think that a broader view of the role of assurance will equip boards, as well as their assurance providers, with the skills and flexibility needed to flourish in the information age.

The questions in this consultation paper add up to one big question: where can – and should – the assurance market be going next?

Share your views

We've told you what we think, now we want to hear your thoughts on the future of the assurance market and in particular:

- Rather than focusing on the annual report – or any other single report of an organisation – we should think about the right way to use assurance to meet the needs of the organisation itself.
- The role of the board in determining the need for assurance, internally and externally, is vital to understanding the future of assurance.
- Getting the right assurance in the right place is essential. This means asking the right questions about risks and information flows, and in a complex organisation it means keeping track of the situation with an assurance map.
- Assurance can be provided over risk disclosures or forward-looking information, even if the question asked is different from 'is this true and fair?'.
• Assurance can add value to narrative information using current principles and techniques, and the skilled judgement of preparers and assurance providers.

Please send comments to ruth.ward@icaew.com or via icaew.com/assurancewherenext by 22 July 2016.

The audit and assurance innovation panel

In 2013, ICAEW brought together investors and assurance experts to discuss this fast-developing field and created The Audit and Assurance Innovation Panel (TAAIP). The panel works to share emerging best practice, develop innovative thinking and look ahead to where the assurance market is going next.

As part of its work TAAIP produces publications discussing developments in the assurance market including The journey series. To learn more about the work of TAAIP, and to get involved, please contact Ruth Ward at ruth.ward@icaew.com.

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ICAEW and assurance services

All types of business, public and voluntary bodies, investors, governments, tax authorities, market regulators and their stakeholders need to be able to rely on credible information flows to make decisions. Confidence suffers when there is uncertainty about the integrity of information or its fitness for purpose.

ICAEW's **Audit and Assurance Faculty** is a leading authority on external audit and other assurance services. It is recognised internationally by members, professional bodies and others as a source of expertise on issues related to audit and assurance.

The assurance thought leadership programme aims to:

- Find out where assurance services could strengthen markets and support economic confidence by making information flows more credible.
- Ask how the **International Framework for Assurance Engagements** can be applied and developed.
- Answer demands for practical guidance to meet emerging market needs.
- Share best practice examples and promote the high-quality assurance engagements already carried out by many ICAEW members.

To learn more about what assurance can do, take a look at the articles, guidance and reports on icaew.com/assurance or telephone Ruth Ward on +44 (0)20 7920 8639.

Join us

Find out more about ICAEW's Audit and Assurance Faculty and how to join at: icaew.com

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Because of us, people can do business with confidence.

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www.charteredaccountantsworldwide.com
www.globalaccountingalliance.com

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

T +44 (0)20 7920 8450
E tdaf@icaew.com
icaew.com/assurance

 [linkedin.com](https://www.linkedin.com) – find ICAEW
 twitter.com/ICAEW
 facebook.com/icaew

