

The perception of statutory auditors' justification of assessments

Presentation to the IAASB

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Footprint
> CONSULTANTS

A few words about Footprint > consultants

Footprint > consultants is a strategy consulting firm founded by Philippe Manière in 2008 and offering a range of services that enable its clients to maximize their strategic and media « footprint », with a recognized capacity in gathering information and insights for independent studies.



Philippe Manière has more than 25 years of experience in consulting, media and the non-profit sector.

- An economist by training, business administration and law degrees
- Was first a journalist specializing in economic and financial issues in major French print publications (Le Point...) and radios (Europe 1, BFM...)
- 2004-2008 headed the most influential French think tank, Institut Montaigne for 5 years
- 2008 created *Footprint > consultants*

Objectives & Methodology

- French National Institute of Statutory Auditors asked Footprint > consultants:
 - to **collect and present the views** expressed within statutory auditors' professional environment in the broadest sense;
 - and
 - to **determine**, on the basis of the information gathered, **whether and to what extent the statutory auditors' justification of assessments is seen as a “plus” by users** of statutory auditors' reports
- To perform the assignment, *Footprint > consultants* conducted a series of interviews with a series of users of statutory auditors' reports with the following interviewee base:
 - 21 interviews conducted (1 hour and a half in average)
 - 34 users of statutory auditors' reports

Details of the interviewee base

34 people met representing 21 organizations

Supervisory & control authorities

- H3C
- French financial markets authority (*Autorité des marchés financiers* – AMF)
- ACP (French banking and insurance regulator)
- Comité de la Charte (private non-profit organization that certifies and monitors associations and foundations that request donation from the public)

Audited entities & issuers

- Professional associations representing the interests of companies:
 - the AFEP association of French private-sector companies
 - the Medef employers' confederation
 - the CGPME general confederation of SMEs
- Banks, represented by their professional association, the French Banking Federation (FBF)

Various categories of financial information consumers

- Financial analysts from 3 top-ranking investment houses in Paris, representing the French Association of Financial Analysts (SFAF)
- Specialized journalists
- Business / fund managers
- Investors (CDC)
- Investment managers (AFG-Asffi)
- Representatives of minority shareholders (ADAM)
- Financial executives and management accountants, represented by the French Association of Corporate Financial Executives (DFCG)
- Credit insurer (Coface)

Member-directors & suitably qualified personalities

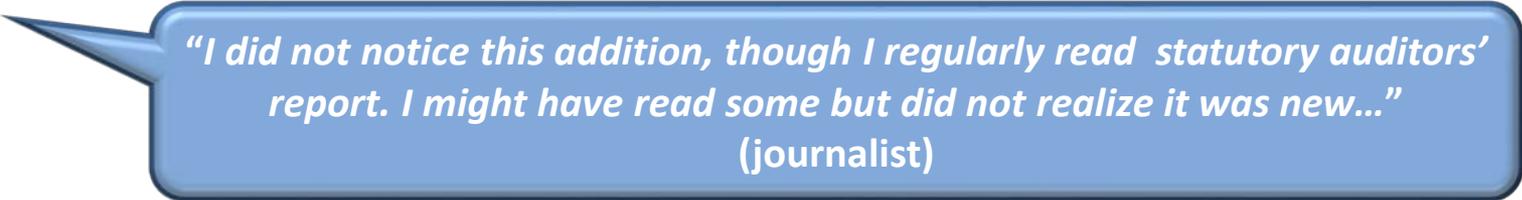
- French Institute of Directors (IFA)
- Board members of Renault, Schneider
- French Treasury
- French Government Shareholding Agency (APE)

Main conclusions / Table of content

1. • A new feature that has gone largely unnoticed
2. • A positive overall response, with reservations in some quarters
3. • Already extensive usage, despite some ambiguities and paradoxes
4. • “Much better than nothing”: the benefits of the justification are recognized by the majority of interviewees
5. • “But can do much better”: the problems adversely affecting the justification’s perception
6. • A procedure that needs to be analyzed from an evolutionary perspective
7. • Internationalization looked upon favorably – and sometimes even hoped for

1. A new feature that has gone largely unnoticed

- A surprising assessment:
 - **Addition not noticed** by at least one quarter of the persons interviewed prior to our study
 - **New feature though used** by some interviewees unaware of this addition



"I did not notice this addition, though I regularly read statutory auditors' report. I might have read some but did not realize it was new..."
(journalist)

- One logically possible explanation: the relative **newness** of the justification (in use for seven years only now)

1. A new feature that has gone largely unnoticed

- Other potential explanations: 4 factors undermining its visibility:
 - **1) Terminology:** a complex, unappealing and even slightly deceptive term (goal is not to justify but to specify the procedures used)
 - **2) Overall presentation of the statutory auditors' report:** 3-section format insufficiently user-friendly and counter-intuitiveness of the order of content
 - **3) Expression:** often a somewhat dry, abruptly worded list of audit procedures, described in highly technical language and without any semblance of a conclusion
 - **4) Timing:** absence of the justification or audit opinion in the materials most used by financial information “consumers” (financial documents provided by companies in connection with the publication of their financial statements at the end of winter)

2. A positive overall response, with reservations in some quarters

21. No real opposition to the justification of assessments:

- **No clearly negative opinion** of the justification or call for its withdrawal expressed
 - “Acceptance” (not without critics though) of the justification even by the employers’ organizations, some of whom were quite skeptical when the measure was introduced
 - Positive reaction from those who discovered the justification through our study (to varying degrees, but with no hint of outright hostility)
- **Usefulness of the justification acknowledged by nearly all interviewees**, judgment though tempered and nuanced depending on the interviewee category

“The justification has become a standard practice. The corporate community does not intend to go to war on this matter” (Medef – employers’ confederation)

2. A positive overall response, with reservations in some quarters

22. **Reservations** expressed on the justification of assessments:

- **No real enthusiasm** about it:
 - **A nice to have, more or less useful, but not really a must**
 - Doubt about its bringing about a profound or radical change in financial information quality or in their professional life

“It’s not useless but it’s not earthshaking.” (Board member)

- A widely-held feeling of a **discrepancy between what the justification could be and what it is in practice**
 - Perceived as **praiseworthy in theory** but much less so – and even **frustrating – in practice**
 - Viewed though as capable of evolving, often referred to as a work-in-progress

2. A positive overall response, with reservations in some quarters

23. Favorability rate varying from one category to another

- **Highest favorability rate among the priority users** of statutory auditors' reports
 - **Consumers of financial information are the most favorable**
 - Yet, economic and financial journalists, and, especially, financial analysts are less enthusiastic than other regular consumers of financial information

"Justification is a helpful and very enriching addition to the report." (ADAM – minority shareholder lobby group)

- **Supervisory and control authorities are very appreciative** of the justification of assessments

"An essential component of financial information and financial transparency" (ACP)

- **Issuers** and employers' organizations are the most **skeptical**

"Yet another formality" providing "little additional information" (FBF and DFCG)

24. **Awareness of the difficulties associated** with the justification expressed by all interviewees

- No hint of acrimony, even by those expressing frustration or dissatisfaction with regard to the justification of assessments

3. Already extensive usage, despite some ambiguities and paradoxes

31. **Enriching reading for the initiated**, but minimal appeal outside those ranks

- Assiduous **usage only by those having specialized accounting knowledge**
- Need for **acquaintance with the ins and outs** of statutory auditors' work and with the limits of their freedom of expression to appreciate the worth of the justification most extensively and to greatest satisfaction

"It's for informed professionals only, not for the general public." (AMF)

32. No universal usage, **but rich and varied**

- A tool to **draw attention to highly sensitive items** and, therefore, those which most merit investigation
- A **dynamic comparative reading's tool**, to compare the justifications included in the statutory auditors' report
- A **factor of exchanges** between the statutory auditors and the audited company, particularly the company's audit committee
- A **complementary tool for supervision and control authorities** as part of their respective work

4. “*Much better than nothing*”: the benefits of the justification

41. A **constructive shade of grey** in a **predominantly black and white report**

- A departure from the inevitably binary nature of the statutory auditors’ report, **bringing nuances, showing more subtlety**, according to supervisory and control authorities; financial information consumers; Board members
 - Nuance to this judgment: statutory auditors’ traditionally binary report appreciated by representatives of issuers for the safety it affords
- **Unanimous acknowledgement of the subtlety and complementarity** provided by the justification, though appreciated more by financial information consumers and supervisory and control authorities than by issuers

“Before, there was either certification or qualified certification (synonymous with disgrace). But the truth is that the absence of qualifications does not guarantee that there are no problems.” (ACP)

4. “*Much better than nothing*”: the benefits of the justification

42. Widespread **appreciation of the quality of the additional information** provided

- A useful way **to complement and enrich the report**, without however complicating the readers’ understanding
 - A boon to regular consumers of financial information (always in favor of more financial information for the purpose of forming an opinion)
 - A boon to all shareholders, even if it goes unread by them (it has the merit of being publicly available)

“A pertinent complementary information is always appreciated given the – frustratingly – succinct nature of the statutory auditors’ report.” (AFG)

- A **complement to be kept within limits**
 - Importance to remain within the confines of the statutory auditors’ legal obligations

“As an issuer, I am not in favor of having the statutory auditors say more. Of course, were I an investor, I would be in favor of expanded disclosure.” (CDC)

4. “*Much better than nothing*”: the benefits of the justification

4.3. A **reference material / reading grid** for the financial statements and the now expended management report

- A **compass** for finding one’s way around financial statements, repeatedly described as difficult to read
- A tool to help **identifying accounting items that are particularly worthy of scrutiny**

“The justification is a ‘little flag’ indicating where we need to dig.” (ADAM)

44. An **advantage for the statutory auditors themselves**

- A tool to **restore audit credibility** at a time of questioning the effective value of the audit report for third parties at international level
- A way to **better reflect the scope of the procedures** performed and the nature of their audit work

“Justification of assessments could – if done correctly – provide some clarification and raise awareness on the substance of statutory auditors’ work.” (AMF)

5. “*But can do much better*”: the problems adversely affecting the justification’s perception

51. A justification **often incomprehensible / cabbalistic** except for rare initiates

- Need to “**decode**” the information contained in the justification
 - **Shared regret that not anybody can understand it**, though minority shareholders are supposedly the priority users of the statutory auditors’ report
 - Recognition by some bodies (AMF, ADAM) that minority shareholders see little point in reading financial statements, therefore not (exclusively) blaming statutory auditors
 - **General call however for a clearer and more understandable style** to enable wider comprehension

“It would be better if they used simpler, more straightforward language, tailored to the individual shareholders attending the General meeting.” (AMF)

5. “*But can do much better*”: the problems adversely affecting the justification’s perception

5.2. An **excessively standardized text**

- A tendency to “**codify any area of freedom**” applied to justification, according to supervisory and control authorities
- A **neutered and sterilized** justification which is not attractive, according to financial information consumers
- A codified text **undermining the usefulness** of the justification, according to issuers

“For non-specialists, it is so codified that it is of no help in understanding what the statutory auditor wished to draw attention to, and the specialists do not need the statutory auditors to tell them where they should start looking.” (Medef)

5. “*But can do much better*”: the problems adversely affecting the justification’s perception

53. The fear of a **jumbled incoherent list**, and of inconclusive descriptions

- **Incompliance with the requirements** of professional standards
- **Uselessness** of a simple recap of the audit work
 - **Need for a conclusion** regarding the “appropriateness” or “reasonableness” of the items or criteria observed for the justification to be useful
- **Ambiguity** of a long inconclusive list for the reader
 - Reassurance or disapproval expressed by the statutory auditor?
 - Nuance on this topic: supervisory and control authorities consider justification should be read unambiguously in the light of the statutory auditors’ general opinion on the financial statements

“The statutory auditor has to avoid a jumbled incoherent list of procedures and just highlight one or two essential points.” (Coface)

6. A procedure that needs to be analyzed from an evolutionary perspective

61. A **spectrum of possibilities** and an evolution that has not gone unnoticed

- A **variability** in the quality of the justifications spontaneously referred to:
 - Mainly **attributed to the quality of the statutory auditors themselves** and how they perceive their roles

“It is obvious, even from a very short text, how some statutory auditors tried to do what is required of them by clarifying the approach used and highlighting sensitive points, while others simply did the bare legal minimum.” (Board-director)

- Considered to have an **impact on the perception** of the justification of assessments and its usefulness
- A potential for evolution regarded as **not always going in the right direction**
 - Tendency to sterilize the wording of the justification and to decrease the content of the justification over the past 5 years

6. A procedure that needs to be analyzed from an evolutionary perspective

62. What **expectations** – and how can they be met?

- The correct most widely-acclaimed approach would be characterized by:
 - **A real focus in terms of the accounting items reviewed**
 - **An as “user friendly” as possible wording**
 - **A conclusion regarding each item listed in the justification**
- Other **complementary ideas** to improve the perception of justification:
 - Using it as a **path of dialogue** and even cooperation with the audit committee
 - **Modifying the form** to “free up” or “stimulate” statutory auditors
 - **Including the justification of assessments along with the financial data** provided when the audited entity announces its financial results
 - **Dialoguing with financial information consumers** to preempt regulatory changes instead of having to race to keep up with them, and to avoid the risk of “falling short” of expectations
 - **Identifying the most effective means of promoting awareness** of the justification of assessments

7. Internationalization looked upon favorably – and sometimes even hoped for

71. Internationalization of the justification perceived as **a benefit for the international financial community and for transparency**

- A potential part of the solution to current preoccupation in financial, economic and international circles since the beginning of the financial crisis:
 - **A pointer** enriching the audit report to be used to enhance transparency in financial reporting
 - **A balance** between the long-form report and the traditional binary reporting style

72. Increasingly **uniform practices expected to enhance audit services** and their perceptions, and to counteract distortions

- Standardization of practices as a means to enhance the quality of the work
- Standardization of the rules applied to place everyone on the same footing

“If everyone is familiarized with the justification of appreciations then French companies would no longer be suspected of producing dubious financial statements. Everyone in all countries will have the same obligations.” (CGPME)

7. Internationalization looked upon favorably – and sometimes even hoped for

73. The “**liberating**” effect of internationalization for French statutory auditors

- The end of a “French exception” enabling statutory auditors to a less inhibited expression

74. A **small number against internationalization** ...who are **open to persuasion**

- An ostensible opposition to internationalization from employers’ representatives
- A potential “**least worst**” **option** though if other measures which pleased them even less were to be proposed internationally

Conclusion

- A procedure which became a standard in just a few years of existence but with still a **way to go**:
 - **Unawareness** of a portion of target users
 - **Criticism** of how it is used in practice, relating to the **form** and to the **substance**
- Two main conclusions:
 - 1) There is undoubtedly **room for improvement** in how the justification of assessments is used in practice
 - 2) The justification **corresponds to a real need** and user frustrations simply bear this out.

This frustration is a reflection of considerable expectations in terms of a tool for analyzing and understanding the financial statements which a simple, unsubstantiated opinion from the statutory auditors – in all its dryness and brevity – can simply no longer satisfy.

Thank you

Time for Q&As...



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