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(check against delivery)
Good morning.

It’s indeed a pleasure to be in Washington this morning and to be among so many friends and colleagues from around the world. As well, this is a great opportunity to meet and exchange ideas with new acquaintances.

This morning I want to share some thoughts around the numerous challenges facing the audit industry – from revenue, growth and audit fee pressures, competition, and governance, to attracting talent into the profession, leveraging emerging technologies, and how to provide more relevant and timely auditor reporting – just to name a few.

These, along with many others, are all issues I believe need to be discussed among investors, audit regulators, audit firms, policy makers and standard setters – issues that impact audit quality and investor protection.

In short, we need to talk.

So, let’s start with a bit of a refresh on CPAB for those who might not be familiar with Canada’s audit regulator. We were established in 2003, and we’ve come a long way in 10 years.
Audit quality in Canada has improved – and we would like to believe that CPAB has been instrumental in its advancement. Still, while audit quality has improved, in my view we are not yet where we need to be. And based on the current environment, I believe that we will all face significant challenges in our journey over the next few years.

In CPAB’s development we have focused on the reliability of the audit – looking at the firm’s quality processes and inspecting files to ensure those processes delivered a quality audit. In recent years we have also focused on broader issues like how a firm is structured, how they deploy resources, where does the accountability for audit quality reside in the organization, and so on.

The point has been to examine how the firms embed quality into their culture and behaviors. How are they addressing issues of consistency of execution or lack of professional skepticism or professional judgment? Against this backdrop we know the environment in which the audit industry operates is changing and potentially rather dramatically. There are a great number of issues to be identified and discussed; issues that could substantially impact audit quality and investor protection over the next five years.

I’d like to take the next few minutes to reflect on that changing environment and specifically some issues that, in my view will, significantly impact the audit industry as we know it today. Before I get to the specific areas, let me provide a little context.
First. How relevant is an audit today and to whom? As regulators our focus is mostly on reliability. I hope Boards of Directors, audit committees, and investors value an audit re the assurance side. But does the audit create value for a company? Is it relevant for investors? Or is it strictly compliance driven? Would the audit, and specifically the audit report, be more relevant if it discussed / disclosed key audit matters / critical audit matters?

Second. All the Big Four firms have announced their strategic focus going forward. Not surprising, they all want to grow their businesses. One of the firms has set a target of doubling revenue from $25 billion to $50 billion by 2020. The plan as I understand it is to build or acquire a variety of consulting skills or capabilities which would be of value to their clients. In fact, a number of firms have acquired legal/law practices. While we do hear of the major acquisitions of consulting firms by the Big Four, I was surprised by the number of small consulting firms in Canada also being acquired by the Big Four.

Is the Big Four’s consulting growth a strategy to increase their relevance to their clients? How will this affect audit quality?

Third. Now while I have you thinking about the environment, let me ask how much has changed in the last 50 years on how an audit is performed. In my view, very little. Yes, audits have become more complex and more global in reach as public companies are more complex and global. But let’s focus on what has changed in the way
the audit is performed. In the ‘70s when I was doing audits, the files were paper. Today, audits are done on laptop computers. However, we still select samples, verify cash and receivables, etc. re-confirmations. So I ask, could technology change how an audit is performed? Could technology increase the reliability and relevance of an audit?

My view is that given this environment we need a full discussion on the potential impact on audit quality. Let’s look at the pros and cons. One could argue that all these potential changes will improve audit quality.

At the same time, I could argue that, if not managed, they could have a negative impact. That’s why we need to talk.

We need to have a dialogue. We need to include every stakeholder with a vested interest in audit quality: investors, audit committees, regulators, standard setters and the firms.

Let’s take a look at six areas where I believe an effective dialogue is needed:

1. Trends in Firm Revenue and Firm Growth Strategies
2. Competition
3. The Partnership Model
4. Governance in a Global Structure
5. Human Resources
6. Technology

1. We’ll start with Trends in Firm Revenue and the Firms Growth Strategies

The Big Four audit firms typically deliver three types of services: audit (or assurance), tax, and consulting (or advisory). While advisory services continue to be the primary source of revenue growth for the Big Four global networks, all three service areas experienced lower growth rates in 2013 compared to 2012.

Revenue from assurance services decreased in 2013 compared to 2012. Firms are reporting downward pressure on audit fees due to the economic climate – users are questioning the value of an audit and rival firms are underbidding. As a result of fee pressures and slower growth, assurance revenue accounted for 43 per cent of Big Four global network revenue in 2013, compared to 46 per cent in 2011.

Acquisitions of consulting businesses are playing a prominent role in driving Big Four advisory revenue growth. In recent years, the Big Four audit firms have been active acquirers of consulting businesses, growing their range of services to include legal, management consulting, immigration, technology, and other discrete specializations.

Advisory businesses differ from audit in fundamental ways, including:

- The nature of the client
• The nature of competition
• Pace of service innovation
• Backgrounds, mind-set, skill-set of the people / staff
• The revenue model – typically one-time
• The cyclical nature of the business

Differences between advisory and audit businesses could create stresses and conflicts within the firms, including some conflicts that could threaten auditor independence. In some jurisdictions there are prohibitions on the provision of non-audit services to certain audit clients.

Despite the conflicts, there are reasons why firms are actively growing advisory services.

• Permits firms to grow and offer opportunity to firm personnel
• Expands the scale and scope of the firm’s brand
• Builds out the firm’s global footprint and deepens competencies, allowing the firm to better serve global clients
• Leverages the trusted business advisor relationship that the audit partner has developed offering opportunity to increase profit maximisation from a client relationship
• Creates more opportunities to cross-sell a wider variety of services
• Creates a bigger firm that is less susceptible to shocks to its business
Expanding advisory services may improve audit quality to the extent that the firm deepens competencies needed to compete for and perform audits and harnesses those competencies when conducting audits.

But what happens if audit becomes just five to ten per cent of the firm’s revenue and activity. What happens if consulting represents 60 per cent or more of the revenue and activity? What is the impact on firm culture? On audit quality?

2. The second issue I want to talk about is competition
What is happening to competition in the audit market?

Competition is the lifeblood of the capital markets, and indeed of our economies.

It drives innovation.

I think we’d all agree that there’s been relatively little innovation in audit, at least compared to other industries.

Basically, we operate in 2014 like we did in 1964 – with a few changes along the way.

So when competition in the audit industry constricts, it’s never a good thing.
But that is what’s happening.

In the late 1980s, eight firms provided audit services to large, publicly-traded companies around the world.

Today, four do.

What’s more, the Big Four share 67 per cent of the global accountancy market.

Large audit clients perceive they have little choice in auditors as they often do business with other major audit firms – in other business areas – that would represent a conflict if that firm were to also become the company’s auditor.

Large companies tend not to change auditors frequently – it’s a major disruption, and the costs are high, including the costs of educating new auditors.

Some jurisdictions, operating under the well-established belief that competition is a good thing, have implemented measures to increase it through the supply of audit services to large companies.

In the United Kingdom, changes were made in September 2012 to the UK Corporate Governance Code – which applies on a comply-or-explain basis – to state that FTSE 350 companies should put the
external audit contract out to tender at least every 10 years. The EU has also put in place mandatory firm rotation legislation. One of the stated objectives was that the legislation would benefit competition and assist the mid-tier audit firms in gaining access to audits.

To date, the changes appear to have had a limited impact on competition – larger companies have continued to engage one of the Big Four firms.

But what if there were eventually only three big firms, or two?

What would that do to quality, and innovation, and fees?

These are all questions worth talking about.

And there are others. Will recent initiatives to provide observability into the quality of an audit, such as the development of audit quality indicators and revisions to the auditor’s report, change the way audit firms compete?

Will they incent audit quality and innovation?

Clearly, the questions don’t get easier; again we need to establish a dialogue.
3. On to my third issue – Is the Partnership Model Sustainable?

Many jurisdictions have regulations concerning the form of business for accountants or the ownership of audit firms. For historic, licensing and other reasons, the Big Four firms are structured as private partnerships rather than as corporations in most jurisdictions.

In a partnership model, each partner has a personal stake in the business which may increase incentives for partners to effectively monitor the activities of each other. The partnership structure limits an accounting firm’s ability to raise capital. Also, local laws may restrict ownership of economic interests in the firms to individuals who are licensed accountants.

At the same time, a partnership model provides audit firms flexibility in structuring their governance. Often, internal governance comes from various committees drawn from within the firm, whose members are elected or chosen by firm partners or the chief executive officer.

Partner compensation at the Big Four is generally a function of several factors that may vary by firm. Is audit quality one of those factors? Losing a client may have negative personal implications for the engagement partner’s compensation.
Litigation may relate to any of the services provided by the Big Four, including auditing. It has been reported that class actions against the world's largest auditing firms are spreading globally as governments bolster investor protection laws in countries where the Big Four audit firms have never before faced substantial legal risks.

Each member firm within the Big Four global network is a legally separate affiliate. This structure somewhat insulates other members within the network if one national practice incurs significant litigation liability.

If one or more significant network member firm incurs a substantial litigation liability, the entire network may be adversely affected. For example, in the case of Arthur Andersen, the failure of the US network member firm was catastrophic for the entire network.

So, all of these considerations beg at least three questions:

1. Is the partnership compensation model effective in promoting audit quality?
2. Does the partnership model offer sufficient capital to fund adequate investment in audit quality?
3. What effect has trends in the amount of litigation against firms had on audit quality?
4. Now on to issue four – Governance within a Global Network

Structure

Each of the Big Four global networks is managed by a global board or council that has overall responsibility for the governance and oversight of the network member firms. The composition of these governance bodies varies but generally includes senior leaders from different service lines and geographic regions.

So, how effective are the firms’ current governance practices? Where does public interest reside? Where is the accountability?

Who is ultimately accountable for audit quality?

To what extent should policy makers consider developing and/or enhancing guidelines regarding audit firm governance at the global or individual firm level?

Other than for the partnership model, what implications would alternative business structures have on managing the balance between professionalism and commercialism? I understand that the firms must be effective and profitable, that’s the commercialization side. They also need to be a profession which operates in the public interest.

I believe these questions raise serious issues and again a dialogue is needed.
5. The Quality and Extent of Resources in the Labour Market – that’s issue number five.

Globally, the Big Four firms employ more than 700,000 people. We don’t know how many are being hired into the audit practice rather than advisory, but we do know that 80 per cent of audits today are being done by those with less than five years of audit experience.

The factor of experience – or lack thereof – is significant, and so is the generational challenge.

As the Baby Boomers, and soon even the eldest members of Generation X retire – it’s hard to believe, but the oldest Xer is 49 today – it will be left to the Millennials to run things.

And in case you haven’t noticed it, they work differently than previous generations.

They’re big on work-life balance, and won’t accept the long, grueling hours that their predecessors agreed to, and even embraced.

A lot of partners in accounting firms say they’re making more money than they ever dreamt of, but have no time to spend it.

The Millennials won’t roll like that.
They'll take less in order to do less.

This combination of factors will exert a great deal of pressure on labor resources in the accounting industry, and by extension audit. If these are the issues then I figure we should be talking about them.

For example, what can be done to encourage individuals with the necessary knowledge, skills, and abilities to embark on and remain in a career in auditing?

What implication does no or very slow revenue growth in the audit profession have on attracting and retaining talented individuals over other professions or lines of practice?

Are the auditors of complex corporations adequately skilled? What can be done to improve the education and training for auditors to prepare them for audits of complex corporations?

The audit personnel of the future will work in a new world, with new technologies.

6. Which leads me to the sixth and final issue I’d like to raise with you today – The Impact of Emerging Technologies on how an Audit is performed

I said earlier that audit has been done the same way for 50 years.
We’re not known for introducing groundbreaking technology.

Traditionally, the audit has focused on historical information – IFRS, fair value. Increasingly, stakeholders – including investors – are looking to the future.

Firms have indicated they expect technology advancement will significantly impact the future of audit and audit professionals. Use of emerging technologies (currently focused on, but not limited to, mining large amounts of data – big data – and developing sophisticated data analytics) may increase the value of the audit to stakeholders.

Why? Because these technologies will provide deeper insights into – and foresight about – the organization’s operations.

They also may increase the efficiency of the audit.

The use of technology may allow auditors the capacity to examine 100 per cent of a client’s transactions and to sort entire populations of transactions to identify anomalies, making it easier to focus on areas of potential concern and drill down on those items that may have the highest risks.

We may be moving to audit by exception. You identify the audit risks and mitigate them, and 99 per cent of the time you’ll have a quality audit.
While the Big Four audit firms have indicated they’re investing in finding ways to take advantage of the opportunities provided by emerging technologies, there’s little evidence of results – either on audit quality, on the efficiency of the audit, or on the relationship with stakeholders.

When it comes to technology, it seems, we’re still closer to 1964 than 2014. So, we need to be asking:

How are developments in technology, in particular information technology and data analytics, changing the nature of skillsets required for auditors?

How can firms be more innovative in leveraging big data and data analytics in the audit?

With increased use of data in audit, what challenges will firms face in areas such as data security, privacy and completeness and accuracy of data?

So, to my mind those are the six large issues we all need to be talking about: the Trends in Firm Revenue and Firm Growth Strategies, Competition, the Partnership Model, Governance in a Global Structure, Human Resources and Technology.
I think it’s fair to say that in the next five to 10 years, the audit industry will change more than it has in the last 50.

I’d go as far as to say we are on the edge of a transformation in the very way audits are performed.

The audit industry will evolve; how it will be done needs to be discussed. The discussion needs to include all stakeholders with a vested interest in audit quality: investors, audit committees, regulators, standard setters and the firms.

What should our next steps be? In Canada we have our 2014 Audit Quality Symposium this Friday the 21st. IFIAR is working on a paper: Current Trends in the Audit Industry. In October the IFIAR GPPC Working Group met with the GPPC firms. In April 2015 IFIAR will have its plenary in Taipei.

I would encourage you all to get involved in the discussion.

The Audit Industry will evolve, let’s make sure we enhance audit quality in this process

Thank you for listening.

I would be happy to take questions or comments.