

Executive summary

Kairos Future report published in September 2013

Advisory services, accounting and audit in the future – a journey towards 2025

Introduction

Where is the accountancy profession heading?

How is the world at large changing, and what does the profession's journey look like as we move towards 2025? This was what FAR wanted to learn. Kairos Future, consultants for strategic futures, was therefore commissioned to assist FAR in producing a study for the future of the profession – more specifically defined as the accountancy profession.

The study is based on dialogues with representatives of both the profession and other players that have an impact on our profession. FAR members have also identified and analyzed trends at workshops. In addition, around 1 000 members and a large number of businesspeople have presented their views in a survey on the accountancy profession, today and tomorrow.

A profession that predicts the future is a step ahead, well-equipped to avoid pitfalls and better able to embrace the opportunities that come with change. FAR as an institute has an important role to support the members in becoming better prepared for the future. Development is moving swiftly, and some of the events and changes identified by the future study are already on the way to becoming a reality. Everything indicates that we are at the start of a major paradigm shift in the business community and society and one that will have a great impact on the profession.

This study is meant to both challenge and inspire. We must not be afraid of being innovative and we must be able to try out new approaches. Ahead of us there are many exciting choices of route for the profession as a whole, but also for the managements and all the staff of accounting and audit firms. To make the profession's services even more relevant, the change obviously has to take place in close contact with the market.

One thing is for certain: It's going to be an exciting journey, and it starts now.

Driving forces

The focus in the project has been to understand the future. The most important trends in society and in the profession have been identified on the basis of research, interviews, surveys and workshops. Interviews were initially conducted with leading representatives of the profession, among authorities and in the business community. Alongside this, research was also carried out on international and local changes up to the present and significant trends for the future. The result was used as support for those people from the profession who supplemented and prioritized the material.

The combined result of the work on trends is divided into overall driving forces in society, social trends that affect many industries and finally the trends impacting the profession assessed as being most important on the journey towards 2025.

The driving forces are the most fundamental and long-term changes in society. They can be equated with mega-trends and often have a perspective that stretches over 20 years or more. At the same time we need to be aware that we are living in changing times. The driving forces that have been in action for 30 years may in some cases be changing direction. Peoples' values in the western world have, over a long period, become more focused on openness, individualization and freedom. This trend appears to be broken, and the young in particular now prioritize security and structure far more.

When such changes take place in the fundamental driving forces of society, they also affect society more profoundly, and it becomes increasingly important to understand these major shifts. Four driving forces or mega-trends were assessed as being particularly important for the future of the profession.

1. Digitalisation
2. Longing for structure
3. Demography and increased indebtedness
4. Globalisation

Trends in society

Trends in society are long-term trends that often go on for 10-20 years. They are significantly more numerous than the driving forces, and they exist in many parts of society. The trends in society that have been prioritized here are the ones deemed as having the greatest impact on the profession. At the same time, the impact of social trends is widespread. Their consequences can be seen in many industries and parts of society.

Seven societal trends have been identified as most important to the profession towards 2025.

1. Greater transparency
2. Broadened media involvement
3. Digital in real time
4. Location independence
5. The companies drive social responsibility
6. Increasing client demands
7. Private alternatives grow

Trends impacting the profession

The driving forces and trends in society set the context for the future arena for the profession. Among the principal trends there are a number that will have the greatest impact for the future. Here, the knowledge and insight of the profession's representatives and interviewees are the greatest, and material in the form of survey responses therefore accounts for a large part of the analysis.

The eight prioritized trends impacting the profession are as follows:

1. Advisory services and new services on the upswing
2. Auditing less and less attractive
3. Automated services
4. Correct from the start
5. International legislation
6. Differentiated accounting and auditing
7. Demand for active communication
8. Increased demands on the public sector

1. Advisory services and new services on the upswing

"Like the others we are investing more and more into advisory services"

PROFESSION REPRESENTATIVE

Accountancy in the traditional sense has matured, while newer services are growing in most markets. Various forms of advisory services are growing in particular. In a review of the Big 4 in *The Economist*, all four were found to be growing faster in consultancy than in auditing. The services of auditing and accounting are also expanding into new areas such as corporate social responsibility. The concept of integrated reporting is being used more and more commonly as an expression of a broader perspective, especially on issues of corporate social responsibility.

New services also mean crossing sector boundaries. In comparison with both listed companies and smaller companies, the profession stands out in assessment of the effects of the crossing of sector boundaries over the next ten years. 60 % of FAR members view the crossing of boundaries between sectors as a growing trend. Equivalent figures for smaller companies and listed companies are 33 % and 24 % respectively. There is thus a clear expectation that boundaries between sectors will be weakened.

The advisory sections of Big 4 in Sweden already today account for a quarter of the employees. The proportion of turnover they account for is even higher. Around a third of revenues come from the area of advisory services. Advisers on transactions, management consulting and tax and legal matters often demand higher hourly fees than auditors. The proportion of revenues is therefore higher than the proportion of staff.

Crossing of sectoral boundaries and entry into new areas, as mentioned earlier, is not necessarily desirable for FAR members, at least with regard to sustainability. In the assessment of likely development into the future, sustainability reporting is estimated to grow as an area by a slight majority of members, 51 %, but only 40 % regard it as desirable.

There is therefore a significant risk that these areas will be supplied by other advisory businesses than accounting and audit firms.

The only area where members give their organizations a rather low score is in innovation. The changed circumstances in the profession will perhaps increase the pressure on innovation. Given that auditing services are under downward pressure with regard to prices and falling demand from the smaller client companies, it will become increasingly important to expand into new areas. If book-keeping agencies at the same time are under pressure from increased digitalisation, the need for change will be even greater.

2. Auditing less and less attractive

"Recruitment is the greatest challenge"

HEAD OF AUDIT FIRM

More and more women are joining the profession, but they do not stay as long as might be desirable, particularly in the large firms. Men appear to be less and less interested in the profession, and in addition they are less qualified for the task.

It emerges in interviews and workshops that it is very often difficult to retain the best talents. At the same time as there is a natural flow of people who are trained, work hard and then leave, there is concern that too few of the best ones actually stay in the firms. It's possible that there is a correlation between the best people looking elsewhere and the reduced status. There is a risk of this worsening in the future. The picture is probably brighter for advisory services.

New international legislation has meant stricter requirements and more work in accounting and

auditing. However, it has not always been possible to transfer the costs to the clients. The profitability of the services has fallen instead. "When ISA was introduced we ought to have informed our clients that we needed to raise fees by 10 %. It was a major omission that we did not do that," says a representative from the profession.

The clients have thus not felt the pressure on prices as keenly as the firms. The firms look more at revenue per hour, while the clients look at the final bill. Fees charged to clients have not fallen as much as the hourly fee as more extensive work is carried out.

As statutory audit has been removed and may possibly be removed for some larger companies, an over-supply of auditors is developing. Those who previously focused on the smallest clients are trying to take on and prioritize the slightly larger ones. Competition in the market is therefore becoming tougher for everyone.

The trend towards lower profitability and lower status will become more apparent than has been the case in recent years.

3. Automated Services

"The most important contribution of management in the 20th century was to increase manual worker productivity fifty-fold. The most important contribution of management in the 21st century will be to increase knowledge worker productivity – hopefully by the same percentage."

PETER F. DRUCKER IN "MANAGEMENT CHALLENGES OF THE 21ST CENTURY", 1999

Automation to date has mainly taken place in manufacturing, but it is now also growing in the service sector. Knowledge-intensive services are being automated to a greater extent. Many people are aware that in the 1990s a computer succeeded in defeating the world champion, Gary Kasparov, at chess. A computer has now also defeated the leading champions of Jeopardy. The computer Watson, developed by IBM, was able to understand the questions, work out the most likely answer and answer correctly considerably more often than the human Jeopardy champions.

In other words we are seeing a trend in which services offering judgement and knowledge are also on the way to being surpassed by the world's leading computers. In the future there will probably be computers that surpass the capabilities of humans and organizations in more and more areas.

Accounting, auditing and, in the longer term, also advisory services will be far more automated.

Most respondents in the survey answered that they see increased automation of accounting as most likely. The proportion of FAR members agreeing with the statements is shown below.

In the future ...

... automation of accounting services will increase – 80 %.

... automation of auditing services will increase – 45 %.

... automation of advisory services will increase – 22 %.

This picture was confirmed in the discussion during one of the workshops held with representatives of the profession, that is to say it matches well with development to date. We are already seeing ongoing automation of accounting services. It is therefore natural for most members to expect automation of these services. Examples of the automation of auditing services are also starting to emerge in a few markets around the world, for example in the United States, although it is less common. Fewer people in the profession also believe that this area will be automated. The smallest proportion of members believes that automation of advisory services will increase.

Our interpretation is that this reflects the time and the current extent of automation. On the other hand, it is unlikely that auditing and advisory services will be unaffected. It will take a little longer, but development will move in that direction in these areas as well.

4. Correct from the start

"The actual attest function (of auditing) has probably had its day. The ongoing financial reporting is the important information."

CARINA LUNDBERG MARKOW, FOLKSAM

Companies and authorities are starting to set stricter requirements so that everything is correct from the start and can therefore be collated, analyzed and reported continuously. Good IT-support and regular follow-up and reporting are becoming more important, while the audit comes afterwards and is of lesser significance. It is not just the annual general meeting that is very often perceived to be something of a formality. The annual report and the audit report also become pleasantly framed formalities. There are, of course, companies that profile themselves by their annual reports and make them interesting from other points of view, particularly for PR and investor relations. On the other hand, the reported figures are already old and do not have any major impact on the market's assessment of the company.

This trend is driven further by development towards more digitalised and accessible information. It will perhaps not just be the annual report that becomes a formality and old information in the future. Current reporting appears capable of playing an ever greater role. In line with the high-frequency trading in the market and on the stock exchange, dictated by decisions in milliseconds and even microseconds, the reporting and financial position of the company is evaluated in real time.

It therefore becomes increasingly crucial for reporting to already be correct when submitted. This trend is also apparent for private individuals with regard to the Swedish Tax Agency. Citizens report less and less on the actual tax return, as an ever greater share of the documentation is already registered at the Swedish Tax Agency. In the longer term it is expected that silent acceptance will become increasingly common. If you do not respond, you automatically approve the tax return. In the longer term this will also become possible for companies to a greater extent, which will have significant implications for the profession.

5. International legislation

"Internationalization has become more tangible – financial reporting standards, auditing standards, forms of co-operation and also the licensing authorities co-operate across borders, which places greater demands on auditors. The role has been strengthened in this way, for example in the fight against crime, reporting obligations and money laundering."

ANITA WICKSTRÖM, SUPERVISORY BOARD OF PUBLIC ACCOUNTANTS

The profession is governed to a larger degree by international legislation and recommendations. Rules for advisory services, auditing and financial reporting are decided in the EU, IFAC, SEC and other organizations.

Members of the profession also expect international legislation to govern their activities more than companies in general do. 82 % of FAR members think that EU-legislation will govern their activities more over the next ten years. Equivalent proportions for listed companies and smaller companies are 67 % and 34 % respectively. The differences may to some extent be due to Swedish legislation being introduced that is actually compelled by EU-legislation. Smaller companies do not perhaps always know the reason for the new Swedish legislation. The removal of the statutory audit requirement was strongly influenced by guidelines from the EU. The introduction of an audit committee for larger companies

likewise, as was also stated in the Swedish Government Official Reports on which the decisions have been based, for example SOU 2008:32. The audit committees are now on the way to being given a stronger role in future legislation. They can become a “fifth body” of a Swedish company, together with shareholders, board of directors, chief executive officer and auditor.

Part of the explanation as to why the profession sees international influence as being more significant is probably that financial reporting and auditing are governed to a great extent by EU-legislation. The freedom for Sweden to have differentiating national legislation in these areas may be reduced more rapidly than other legislation affecting the world of business.

"The EU – on the one hand all these proposals for rules are rather negative. They're easy solutions from politicians that are often clumsy and don't take into account the differences between countries. On the other hand, we need to have common rules in the longer term. For example, the fact that countries have now competed with taxation slows down internationalization and creates a messy situation for companies."

REPRESENTATIVE OF THE PROFESSION IN AN INTERVIEW

For Swedish companies it is primarily a worsening. It means more extensive and expensive regulation, for example IFRS and ISA. However, more rules need not always mean a worsening. Although it is easy to be wise in hindsight, there are often situations where additional problems are uncovered and for which adjustments are needed. This is particularly the case for societal or public interest entities, for example in view of the many companies now regarded as “too big to fail”. A clear majority, 71 % of FAR members agree with the statement that “the profession should promote tougher legislation of reporting for public interest entities.”

At the same time, the Swedish system, based more on principles and less on rules, has also made more adapted and advanced work possible for auditing and accounting. If the rules become too numerous, accounting and auditing will eventually be so governed by coercive rules that the assessments of what is material and relevant becomes less and less important. This may be reasonable in a society where it is not possible to rely on anyone very much. In the United States it is not assumed that companies will do the right thing of their own accord, and the legislation is consequently far too extensive seen from a Swedish point of view. If there is social control, with citizens that, to a greater extent, can be relied upon to do the right thing, it is more effective to have simpler, principle-based legislation and even self-regulation. The legislation is perhaps formulated on the basis of a different social context than a society that works well and has a sense of duty. This legislation may therefore be unnecessarily formal for our culture but better suited to others.

At the same time harmonized legislation provides support for advisory services, accountancy and auditing for international companies. If all legislation was local, it would be difficult to understand and compare consolidated figures. Knowledge and understanding of financial reporting in different companies is now more generally available.

6. Differentiated accounting and auditing

The expression “an audit is an audit” used to be commonly heard. This is less self-evident today and will be even less so in the future. Audit no longer follows one and the same method. Simpler auditing, or no auditing at all, is becoming more common for smaller companies while larger companies have more complex financial reporting and auditing. Listed companies, international companies and financial companies generally face tougher legislation. The statutory requirement for an auditing committee for listed companies in 2009 is an example.

The representatives of the profession also see a clear need for differentiation. As mentioned earlier, a clear majority want public interest entities to be subject to tougher legislation. One

size actually doesn't fit all.

Willingness for legislation is also widespread internationally for public interest entities, particularly in the financial sector. The United States, the EU and others want to introduce ever tougher legislation. The Swedish Financial Supervisory Authority has also expressed a wish for auditors to report irregularities directly to them.

There is also a risk of international companies being affected by the legislation of other countries and being subject to more complex ruling on the grounds that they are international. More and more companies operating in the American market are part of a system with lawsuits and sky-high lawyers' expenses which pose a great challenge to businesses.

The American financial reporting rules, US GAAP, are more extensive than IFRS. It is therefore advantageous for many companies to bypass US GAAP and report under IFRS. The costs faced by those who have to report and take account of both frameworks are high.

International standardization, the risk of being sued, and so on mean that auditors are often unwilling to make statements about the companies being audited. In light of this it is understandable that the Swedish Financial Supervisory Authority and authorities in other countries face difficulties in wanting auditors to report irregularities directly to them.

If a reduced degree of confidentiality was allowed for particular public interest entities, the differentiation of auditing would be increased further. At the same time it can be asked whether it should be the annual general meeting that appoints auditors and the company that pays the audit fees. A different type of auditor is perhaps required, and their work could actually become similar to the work performed by the Swedish Tax Agency during tax auditing.

7. Demand for active communication

"Board work used to be a black box, now you find out what's happening. We receive far more information about the board's work today. This is a consequence of distrust of the board and the fees the directors receive. The same discussion is now coming for auditors."

CARINA LUNDBERG MARKOW, FOLKSAM

Auditors are criticized for not managing to sound the alarm bell before a corporate scandal occurs. The audit report is regarded as rather a blunt tool, and more and more people want auditors to devise methods to communicate in a readily understandable way. There is no clear support in the interviews for communication from the auditor at the annual general meeting. There are, however, other stakeholders voicing that auditors should express their views more than they do today.

When looking at how different players view development, it is FAR members who see the greatest change ahead of them. A slight majority agree with the statement that auditors will have a broader assignment in the future. It will also become more important to communicate what work has been carried out.

A great number of companies who have the option of opting audit actually choose to retain it. At the same time it appears now legitimate to question what the auditor actually does, and what benefit the auditor provides. It is therefore becoming more important to explain what work is carried out.

The auditors and CEOs of the smaller companies largely consider this development as being

likely. 78 % of FAR members and 67 % of companies believe that it will become more common in the future for auditors to describe their own work in more detail. Both these groups foresee a trend towards the reporting of risks and future prospects becoming more common.

The representatives of listed companies believe to a greater extent that auditors will run a greater risk of being sued. They also believe that review of environmental issues, ethics and corporate social responsibility will become more common.

This is in part a picture that is also shared among auditors. Those who work with the smaller companies see CSR as coming further down the list of priorities, while those who audit the largest companies already see it as part of the trend. There are already sometimes requirements for this in procurements from listed companies.

8. Increased demands on the public sector

"Municipalities need auditing."

INGA-BRITT AHLENIUS, A FORMER HIGHER UN-OFFICIAL, IN DAGENS NYHETER, 29 JULY 2013

With the increasingly strained finances of the public sector and the growing contribution from private players, the need for professional management, quality and control is becoming clearer. There is now greater focus on quality reporting, follow-up and governance in public-sector activities, both publicly funded with private-sector providers and publicly run operations.

When there was only one alternative for a healthcare provider and this provider had a minor interest in profit, it was not so important to measure quality and results. When the number of healthcare providers increases it becomes important to ensure that the outcome is measured and controlled more clearly. For a private company to know what is expected there is a need for clear procurement procedure and also regular review and dialogue.

If simple products are to be bought, procurement may be completed when the products have been delivered and payment has taken place. When complex services are to be procured, the delivery is not completed until much later.

More and more people want quality and follow-up to improve. Just because a business is run under public management does not mean that it is without problems. As the obvious need for evaluation of the private-sector players becomes clear, a positive side-effect may be improved quality and development of public operations. Capio Sankt Göran hospital has been run at lower cost and with higher levels of satisfaction among patients for many years, and now the public hospitals have also been inspired and developed. "They have become almost as good," according to Åke Strandberg, one of the senior managers at Capio.

The public sector cannot hide behind its position as an authority but needs to be audited and improved and must process opinions in a constructive way. It is not just in national politics that there are constitutional committees where a lot is said but with little consequence. Criticism can also easily be "forgotten" at local level, for example because a municipality is unwilling to change. Evaluation, quality assurance and auditing need to have consequences even for these operations and not simply be filed away. Inga-Britt Ahlenius has, in a number of articles, referred to a great need for auditing and ways of demanding responsibility within municipal operations. They need audit and follow-up just like private-sector businesses.

It is highly likely that these matters would be made easier if the audit was performed by external players subject to legislation similar to that of private-sector companies. In other words, there is a great need and a great opportunity for the profession to meet that need.

Conclusions on trends impacting the profession

There are great challenges for the profession even in the short term. The trends outlined are changes in progress, and those who exploit the opportunities best will have greater prospects of being successful in the future. For this to happen, the profession must definitely become more proactive, innovative and attractive, both for clients and for staff.

Creating new services and offers on the basis of changed legislation has always been a strength within the profession, but perhaps the pressure now is greater.

The challenges are not just about minor adjustments but rather about a profession that will be radically changed. How will the range of services look when the extent of the audit is greatly reduced, when accounting services are automated and when advisory services to a greater extent have to be supported by technology? How does one attract, develop and retain the best talents, which today and in the future have completely different values and views on the work to those of previous generations?

An important issue is how the profession is to relate to the increased requirements for transparency and communication from auditors and advisers, as well as requirements to communicate risks, irregularities and future prospects for clients to a greater extent.

Many issues are probably larger than any individual player is able to resolve, and there is a need instead for the profession to come together to highlight perspectives, be proactive and impact the future.

Key questions

In order to make the profession successful in the coming decade these key questions are identified as important to address:

- How can we make auditing continuously relevant, deliver more value and communicate the value to clients?
- How do we want to define the profession in the future when advisory services have become more dominant?
- How can the profession coexist with and take advantage of digitalization and automation?
- How can the profession remain attractive for young talents?
- How can the profession address the growing importance of advisory services?
- How can the risks of firms failing, and large damages claims best be handled by the profession?
- And most important of all – how do we create a sense of urgency?