

IAASB

INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD

Future of Auditing: Audit Quality, Implementation and Innovation

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Agenda

- Role and Relevance of Auditing, Current Challenges
- Audit Quality
- International Auditing and Assurance Standards: Adoption and Implementation
- Innovation and Responsiveness – Current IAASB Initiatives and Activities

Role and Relevance of Auditing

Investor confidence is fundamental to the successful operation of the world's financial markets. When making decisions about capital allocation investors need to know that financial information they are given is credible and reliable. The quality of audits and audit opinions on financial reports are crucial to achieving that. Independent auditors play a vital role in enhancing the reliability of financial information by attesting to the veracity of the financial statements.

The external audit is the first external independent line of enforcement of financial reporting standards and financial reporting law. Audit is one of the vital filters that ensure that users of financial statements can have confidence in them.

[Jane Diplock, Chairman, New Zealand Securities Commission. *Importance of Audit Quality and Auditing Standards*. Speech delivered in Wellington on 11 November 2005]

Role and Relevance of Auditing - Fundamentals

- The external audit
 - Underpins quality and credibility of financial information, and public confidence in financial reporting and disclosure
 - Is a critical part of regulatory and supervisory infrastructure
 - Is an activity of significant public interest
- Failure to deliver high quality audits \Rightarrow adverse consequences: for corporate entities and investors; for efficiency and effectiveness of domestic economies and capital markets; and for financial stability of the international financial system
- The perceived value of the audit is influenced also by perceptions of its relevance

The Global Financial Crisis

- Unparalleled stress on financial markets and the world economy
 - Effects include financial turbulence and spill-over effects; economic and social disruption
 - Amplified the need for, and importance of processes that promote international financial stability
- Institutions and processes that contribute to financial stability are being extensively re-examined
- Fundamental questions about future of auditing:
 - The value of auditing is strongly affirmed
 - The role and relevance of audits can be enhanced

Challenges for the Future of Auditing

Question: What contemporary factors influence the long-term sustainability of auditing? Its role and value in society?

- Significant increase in complexity of financial reporting and financial information disclosure
 - Relevance from the perspective of users?
 - Scope of the financial statement audit questioned
 - Nature of audit processes and auditor judgment under scrutiny
- Call for enhanced auditor communications
- Call for greater transparency: for audits and audit firms

International Efforts to Strengthen Auditing

- Substantial recent policy efforts worldwide, including:
 - IFAC: Public interest reforms in 2003 (incl. establishment of public interest oversight through the Public Interest Oversight Board); Global Study of Financial Reporting Supply Chain (2008-2009)
 - Europe: EU 8th Company Law Directive (2006); UK Financial Reporting Council initiatives (2006 – 2008)
 - United States: Report of the US Department of the Treasury Advisory Committee on the Auditing Profession (2008)
 - Australia: Corporate Law Economic Reform Program law changes affecting auditing and auditors (CLERP 9 – 2004); Australian National University research report “The Future of Auditing” (2009); Treasury Consultation Paper on Audit Quality (2010)

Australian Research Report on “The Future of Auditing”

- ANU Research Report 2009 by authors Houghton, Jubb, Kend and Ng. Describes research findings and conclusions to inform a national strategy on the future of auditing in Australia
- Findings include i.a.:
 - Understandability of the audit
 - Perceptions of deliverables
 - Communications
 - Developing business acumen and industry knowledge
 - Staffing, skills and social impacts
 - Regulatory reforms and their impact
 - Competition
 - Need for other assurance services and reports

The Audit Quality Debate

It is generally accepted in relation to auditing that –

Audits are useful only if there is public trust in the integrity and quality of audits - user and stakeholder perceptions are a key factor

The Audit Quality Debate

- Question: How Good is Your Auditor?
 - Who's interested to know?
- Demand side
 - Consumers of audit services (variety of different users incl. entities – large and small, public interest and non-public interest; governing bodies of audited entities; current and future shareholders/owners, investors, lenders, suppliers, grant-funding bodies)
 - Financial intermediaries (financial analysts); regulators and supervisors
- Supply side
 - Auditors and audit firms
 - Professional accounting bodies

The Audit Quality Debate

- Substantial existing body of research and policy analysis on audit quality (AQ)
- What is AQ?
 - It is described from many different perspectives; there is no universal definition.
 - It is multi-faceted: different users see different aspects as being important to audit quality
 - It is not directly observable or measurable; different proxy measures are identified in the AQ research literature
- AQ is an intrinsic part of IAASB's work
 - High quality auditing standards are one element of audit quality



Important Elements of AUDIT QUALITY

Contextual Factors	<ul style="list-style-type: none">• Governance and Accountability Arrangements• Regulation and Oversight• Players and Perceptions; Markets
Outputs & Responses	<ul style="list-style-type: none">• Auditor's Report• Other Auditor Communications and Disclosures• User Responses and Interactions, e.g. Audit Committees• A Professional Service (client service and audit fees)
Inputs & Indicators	<ul style="list-style-type: none">• Audit Process and Quality Control• Audit Evidence and Auditor Judgment• Auditing Standards• People: Education, Ethics, Mindsets; Culture• External Expectations (also a context factor)

Audit Quality: Context and Importance

- Who is responsible for delivering AQ?
 - Professional auditors and audit firms
 - Auditees and their governing bodies including audit committees
- Many other players influence AQ
 - Regulators and policy-makers, incl. auditing standard setters and auditor oversight/inspection bodies
 - Professional accounting bodies; learning and research institutions

Some Observations ...

- There is increased effort to ‘hard wire’ AQ
 - Firms’ quality control processes and procedures
 - Policy makers look to identify key drivers of AQ
 - Auditor oversight bodies and inspection bodies are proactive in pointing out threats to delivery of AQ
 - Regulators require more transparency from audit firms
- Professionalism and standards; training; use of sound processes and methodologies are important elements
- However AQ is also a contextual concept; how it is achieved inevitably differs in individual audits to some degree

IAASB Work Program and Related Activities

Current focus on:

- Setting high quality international auditing, assurance and internal control standards
 - Importance of the ‘clarified’ ISAs; completed March 2009
 - Responsiveness to user needs – broader needs for assurance
- Promoting international convergence through supporting implementation of IAASB standards
- ISA Implementation Monitoring Project

Promoting International Convergence: Global Acceptance of ISAs

- 126+ countries have adopted or use ISAs in some form
- 23/25 world's largest capital markets accept use of the ISAs
- Endorsement/expression of support from: the Basel Committee; INTOSAI; IOSCO; the World Bank; the World Federation of Exchanges; and UNCTAD
- Financial Stability Board identifies the ISAs as one of the 12 key standards internationally accepted as important for sound, stable and well functioning financial systems
- The EC is considering endorsement of ISAs for use in EU
- Top 22 global networks' methodologies align with ISAs



Promoting International Convergence: Adoption and Implementation of Clarified ISAs

- Inter-linked concepts with different targeted outcomes
- Adoption \Rightarrow as national standards or incorporation into national standards
 - Generally the relatively more straightforward task
- Key adoption challenges
 - National standards and incorporation into legislation under national due process
- Implementation \Rightarrow application by practitioners
 - More difficult ; early planning is essential

Implementation Challenges

- Effective implementation is key to realizing full benefits
- Challenges exist for auditors and audit firms, auditees and national audit regulators/oversight bodies
 - Capacity building, training and education
 - Audit methodologies, programs, manuals
 - Consistent application of the ISAs
 - Application in SME audits; proportional application
- Quality control and compliance

IAASB Support

- IAASB Clarity Center
 - <http://web.ifac.org/clarity-center/index>
 - Background and information on Clarity Project
 - Individual ISAs and Bases of Conclusions
 - Staff Updates, Practice Alerts, FAQs, Q&A, etc
 - ISA Modules
 - Raise awareness and understanding of revised ISAs
 - Main thrust of revised ISAs; significant changes
 - Short videos and supporting slides

ISA Modules

- 6 modules released in 2009

**Introduction
and
Overview**

**Overall
Objectives of
the Auditor**

Group Audits

**Accounting
Estimates
and Fair
Values**

**Related
Parties**

**Communications
with Those
Charged with
Governance and
Management**

- Additional modules are planned for release in 2010

ISA Implementation Monitoring

- Post-implementation review of the clarity ISAs
 - To assess the effectiveness of the clarity ISAs against their objectives, with a focus on consistency of application of the ISAs
 - A longer-range project being carried out in two phases
 - Phase 1 (2009 – 2010/11): Information gathering about experiences of using the clarified ISAs
 - Phase 2 (2012 -): Process to assess effectiveness of the ISAs
- Implications for future IAASB strategy and work program

IAASB Strategy and Work Program

- Key projects with focus on response to stakeholder needs
- 2009 – 2011 strategy and work program
 - User perceptions of auditor's reports
 - Development of international standards
 - Assurance and related services on financial information other than audits (including reviews; compilations)
 - Other assurance services (e.g. compilation of pro-forma financial information; greenhouse gas statements)
- Consultation will commence in Q3 2010 on the 2012 – 2014 strategy and work program

Auditor Reporting

In 2009: Four IAASB/AICPA commissioned research studies on user perceptions of the standard unqualified auditor's report

Authors	Title of report
Theodore Mock, Jerry Turner, Glen Gray & Paul Coram	"The Unqualified Auditor's Report: A Study of User Perceptions, Effects on User Decisions and Decision Processes, and Directions for Future Research"
Brenda Porter, Ciarán Ó hÓgartaigh & Rachel Baskerville	"Report on Research Conducted in the United Kingdom and New Zealand in 2008 Investigating the Audit Expectation-Performance Gap and Users' Understanding Of, and Desired Improvements To, the Audit Report"
Asare and Wright	"Investors', Auditors' and Lenders' Understanding of the Message Conveyed By the Standard Audit Report"
Anna Gold, Ulfert Gronewold & Christiane Pott	"Financial Statement Users' Perceptions of the IAASB's ISA 700 Unqualified Auditor's Report in Germany and the Netherlands"

Auditor Reporting

- December 2009: IAASB discussion of key messages derived from these studies and other relevant information
 - Studies of user perceptions of the standard unqualified auditor's report in different international settings
 - Audits are valued; viewed as serving an important function especially in context of qualifications
 - Expectations gap surrounding user perceptions of the audit is persistent and hard to change
 - Detailed content of auditor's reports is generally not read: value of report is mainly symbolic. There is a need to enhance communicative value of the report

Auditor Reporting/Auditor Communications

- Users generally appear to want more from auditors
 - What users want differs between various types of users
- Research revealed user needs broadly related to:
 - More information about the audit process and about the results of the audit (e.g. materiality thresholds; level of assurance)
 - More information about the audited entity (e.g. qualitative aspects such as quality of financial reporting; adequacy of risk assessment processes)
 - Assurance on additional matters relating to the audited entity (e.g. on effectiveness of the entity's internal controls)
- An IAASB Working Group is further exploring these issues

Audit of Financial Statement Disclosures

- Area of increased risk in financial reporting and auditing
 - Complexity of fair value accounting and related disclosures
 - Increasing focus in accounting standards on requiring disclosures to supplement financial statement amounts
 - Usefulness of financial statements may be undermined if disclosures are inadequate
- Role of professional judgment and materiality
- Discussions with a number of IAASB key stakeholders
- IAASB project to re-examine auditor's responsibilities re quality of disclosures

Meeting SME Needs for Assurance and Related Services

- IAASB efforts until 2008 largely focused on completion of the Clarity Project
 - ISAs designed to apply to audits of entities of all sizes; can be applied on a proportional basis (IAASB Staff Q&A – Aug 2009)
- National developments affecting SME financial reporting obligations
 - Exemptions from the statutory audit requirement
- SMEs may obtain audits on voluntary basis
- However now stronger need for other services also, relevant to the SME financial reporting context

Meeting SME Needs (cont'd)

- High IAASB priority on development of appropriate response
 - First priority on revising existing international standards on financial statement reviews and compilation engagements
- IAASB exposure drafts expected in Q4 2010
- Key areas under consideration:
 - Compilations (non-assurance engagement): scope; work effort and reporting
 - Reviews (limited assurance engagement): work effort and reporting
- Need for additional standards will be assessed once these revised standards are completed

Other Current IAASB Projects & Activities

- Revision of ISAs
 - Using the work of internal auditors (ISA 610); ED in Q3
 - Commenced in 2010: Auditor's responsibility for other information in documents containing audited financial statements (ISA 720)
- Guidance on auditing complex financial instruments (IAPS 1012)
- Assurance implications of use of XBRL in financial reporting
- Future development of the International Auditing Practice Statements (IAPSs)
- IAASB staff publications (Project Updates; Practice Alerts; Q&As)

Research in Auditing

- Research is a fundamental input to high quality standards
- IAASB collaborates with research institutions to promote international research on contemporary issues relevant to auditing and assurance, to inform the work of the IAASB
 - Auditor reporting – research reports in 2009
 - International Association for Accounting Education and Research, and the Association of Chartered Certified Accountants: Four new research projects commissioned
 - Consistency in application of auditing standards
 - Implications of XBRL for the financial statement audit
 - Audit methodology for smaller audit firms
 - The nature of professional judgment in auditing

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