

## **Record Use of Clarified International Standards on Auditing Amidst a Changing Audit Environment**

*Speech by Prof. Arnold Schilder, Chairman International Auditing and Assurance Standards Board (IAASB), at the Pre-General Assembly Conference of the Pan African Federation of Accountants (PAFA), Douala, Cameroon, 8 May 2014*

Ladies and Gentlemen, Messieurs et Mesdames,

It is with great pleasure that I may speak again to PAFA and the leaders of the accountancy profession in Africa. Yesterday I addressed your National Standards Setters, and I was impressed by the lively interest and strong commitment to quality and progress that I sensed. So your theme of this Conference - *Enhancing the Credibility of the Accounting Profession in Africa* - is well chosen.

PAFA comprises both Anglophone and Francophone members. To further serve the Francophone part, I am joined today by IAASB member Cédric Gélard, Technical Director of the French Institute CNCC. Cédric will be happy to share with you some initiatives of CNCC directed at supporting small- and medium-sized practices.

### **Fundamentals in Auditing and the Changing Audit Environment**

Let's start with the fundamental question: Why is there auditing at all? Basically, because audit serves an important public interest. It underpins the quality and credibility of financial reporting and therefore public confidence therein. So, audit is a critical part of the corporate reporting supply chain and society's financial infrastructure. Because of that, failures to deliver high-quality audits can result in adverse consequences for many.

But how would one know whether a high-quality audit, or an audit of lesser value, has been delivered? In particular, those who do not have the benefit of direct access to auditors, such as management or the audit committee, but who can only see a short audit report with a one-line conclusion? Not surprisingly, people will then have perceptions about the value of an audit only based on what they hear or read more generally. This, in turn, will influence their perceptions about the relevance of such audits. So, are audits relevant? And who decides?

If we take a moment to consider the broader environment, we can see why it is not a given that audits are relevant. Firstly, audits enhance confidence about the credibility of financial statements. But financial reporting has become complex. To put it simply: 20 years ago financial statements comprised many numbers, with those numbers further illustrated by some words. Today, we see annual reports of hundreds of pages – many words, illustrated by numbers. This is because today's financial reporting involves difficult judgments, subjective estimates, many disclosure requirements, and a global audience.

Secondly, the global financial crisis triggered key questions about audits: had they been effective to address this crisis? Should there have been more alerts by auditors to critical matters? Was auditors' professional judgment and professional skepticism applied sufficiently? Publicly expressed doubt resulted in numerous large-scale discussions about the relevance of audit, and whether the public-at-large could hold trust in the accountancy profession. It is important to note that such comments often were not intended to be negative. Rather, they were because of the great expectations of the role of audit in society, confronted with uncertainty or disappointment about what it had delivered.

Thirdly, over the years we have heard a groundswell of calls from users of financial statements: “ We want to hear more...” – not only from management and board, but also from their auditors who see and know much about the audited entity but communicate little in their audit reports.

Finally, we have seen the emergence of audit oversight and regulators in many countries, and critical reports coming from them. Recently, the International Forum of Independent Audit Regulators (IFIAR) published the results of a survey of inspection findings which, according to IFIAR, indicated “the persistence of deficiencies in important aspects of audits and that there is a basis for ongoing concerns with audit quality.” Such reports of course influence perceptions of the public with regard to audits and the trust they may warrant.

This brief overview makes one thing abundantly clear: an ongoing, intense dialogue with the many stakeholders to enhance the quality of audit and related perceptions is of utmost importance. Calling that a ‘challenge’ is an understatement.

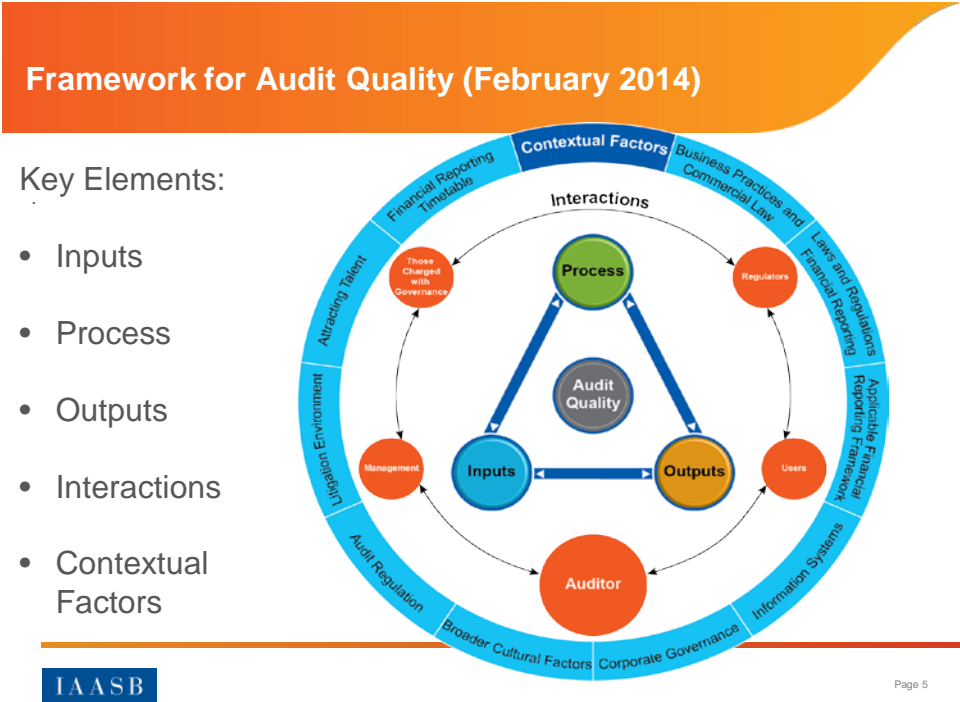
**Some Responses by the IAASB**

The IAASB has worked hard to deliver some responses to the challenges summarized above. This is my sixth year as its full-time Chairman. I am delighted about the great input and support that we received from many stakeholders. This has enabled us to make good progress in a number of areas – of which today I can only discuss some.

*Framework for Audit Quality*

In February 2014, the IAASB released a new publication – *A Framework for Audit Quality*. Our simple but essential goals for this framework are to: raise awareness of the key elements of audit quality; encourage stakeholders to reflect on ways to improve audit quality; and facilitate greater dialogue between stakeholders on the topic. It is a comprehensive publication, for which we cooperated with our fellow Ethics and Education Standard Setting Boards, and with several regulators. Of course we followed an intense due process, with public consultation and many outreach discussions.

The main diagram in the *Framework* is as follows:



The *Framework* analyzes the individual factors of each 'Key Element'. Inputs comprise everything that is part of the auditor's input to the audit process: ethics, professional standards and training, quality control, experience, teamwork, judgment, etc. All essential to achieving a high quality audit.

However, even if all the inputs were fully present and applied, if you would ask an investor whether audit quality had been achieved, he or she would not know much about these inputs, and therefore base the answer on what has been seen as output from that audit – mainly the short auditor's opinion. So the quality and usefulness of the auditor's output is of essence for the perception of the quality of an audit.

Equally important to audit quality is what receivers of that output do in return: how they stimulate and challenge the auditor to make the audit thorough and relevant to their information and assurance needs. This process is also influenced by other forms of output, e.g., from the audited entity or regulators. Therefore, the process in relation to inputs and outputs matters a lot.

This brings us to the importance of the interactions between the various stakeholders, pictured in the inner circle of the diagram. Audits do not take place in isolation, but in exchange with others. While the primary responsibility for performing quality audits rests with auditors, audit quality is best achieved in an environment where there is support from other participants in the financial reporting supply chain. That is a key message in the *Framework*.

Finally, we have to take into account a number of contextual factors. Examples are laws and regulations, financial reporting frameworks, corporate governance and audit regulation.

The IAASB is pleased to note several positive reactions on this *Framework* from regulators, accountancy institutes, accounting firms and academia. Hopefully it will serve the public discussion on audit quality. The IAASB will contribute to this discussion in various ways, including special attention on its website and providing support material.

### *Auditor Reporting*

In recap: outputs from the audit to users, and interactions with stakeholders are highly important to achieve high quality audits and informed perceptions by stakeholders; and there are challenges coming from investors, wanting to hear more from the auditor, and from regulators, wanting to see better. This easily brings us to the importance of high quality, relevant auditor reporting.

The IAASB has been informed by years of research (commissioned in 2006), intense dialogue and several rounds of public consultations. As a result, we believe unanimously that it is of utmost importance to lay the foundation now for the future of global auditor reporting and improved auditor communications. Improved auditor reporting is essential to the continued relevance of – and trust in – the audit profession globally. As mentioned earlier, the start of this discussion is positive: the short audit opinion is valued, but many believe the auditor's report could be more informative. Users, as we learned, in particular investors, want more relevant and decision-useful information about the entity, the financial statements and the audit thereof.

In July 2013 the IAASB published an Exposure Draft package with specific proposals for changes to our extant auditor reporting standards. I do not have the time now to discuss all innovations to auditor reporting that we have proposed, but there are several: placing the auditor's overall conclusion (the opinion) upfront; clarifications regarding the so-called going concern basis of accounting; a statement with respect to the auditor's dealing with 'other information' than financial statements in the annual

report; statements about the auditor's independence and responsibilities; and naming the engagement partner in the case of audits of listed entities. We are very pleased to note the overwhelming number of comment letters that we have received, including from a number of organizations that you represent. Overall, most of these letters are very supportive. We are hopeful, therefore, that we can finalize the changes before the end of 2014.

Let me focus on one key innovation that we have proposed in a completely new standard, ISA 701: Key Audit Matters. Early examples of this can be found in France (the so-called 'Justification of Assessments'), the United Kingdom (where the Financial Reporting Council has already mandated similar proposals), and in my home country, The Netherlands, on a voluntary basis and stimulated by the Parliament! The objective of this new standard is that auditors will communicate publicly those matters that, in the auditor's judgment, were of most significance in the audit of the financial statements of the current period. This will be required for the audits of financial statements of listed entities; we would of course encourage possible wider applicability established by law or regulation (such as recently agreed in Europe) or on a voluntary basis. Such matters would be selected from what the auditor has communicated with the Audit Committee, and based on the auditor's judgment about what of those communications is most relevant to external users.

It is of essence that such Key Audit Matters are relevant to readers. It should not be boilerplate language, but tailor-made to that specific audit. It also should not include 'original information' that management should disclose. But one may expect that the one will stimulate the other. Key Audit Matters will often refer to specific disclosures in the financial statements; in the UK, with now over 80 examples, key audit matters often deal with complex issues such as the valuation of goodwill, financial instruments, or tax provisions.

This innovation in auditor reporting is radical, a 'step-change' as some have called it. It makes the auditor's work more transparent and relevant to users. It stimulates public debate and analysis on what auditors' reports are most helpful. In other words, the auditor is back on the Public Forum – where the Roman name 'auditor' comes from: first listen, then speak out in public where important.

Is this not difficult for auditors, as they hardly have a tradition of communicating to the public anything more than their overall conclusion?

Well, it is encouraging to listen to those auditors who have done or tested this now. They tell us that the engagement partner and team often will have an intuitive assessment of the areas of most significance or difficulty. Of course, the 'how' takes some time. But the examples now speak for themselves, and the auditor's report on Rolls Royce in the UK is commented on as a best-in-class example. Auditors that we have met are proud of what they now are stimulated to do, and what they can demonstrate regarding their expertise, quality and relevance. The IAASB will work hard to finalize soon our standards and guidance to stimulate and assist this important breakthrough.

Ladies and gentlemen, messieurs et mesdames – your conference wants to 'Enhance the Credibility of the Accounting Profession.' I can think of no better opportunity than this new style of auditor reporting!

#### *Services Other than Audits for SMEs*

Small-and medium-sized entities, and small practices serving them with assurance and related services, are of great importance to all economies; here in Africa, and elsewhere. I can only be very brief today, but allow me to mention the recent revisions of our standards on Review Engagements (ISRE 2400) and Compilation Engagements (ISRS 4410). These types of engagements are different

from audits, but can be very relevant to entities that do not need the high level of assurance obtained during an audit.

Review engagements involve obtaining so-called limited assurance, and are less costly than audits. I appreciate the help of IFAC's SMP Committee, which in December 2013 published a Guide to assist in applying this standard. Compilation engagements are provided by practitioners to assist management by applying reporting expertise, without verifying or obtaining assurance or expressing a conclusion in the practitioner's report. National standard setters and national institutes can play an important role in assisting their practitioners with the use of these standards – as with any new standard, there is some investment necessary in order for the standard to become local practice. I am pleased to have heard during the earlier part of this Conference interesting contributions from several global and regional organizations that offer support.

Further, we have recently revised our standard ISAE 3000 for assurance engagements other than audits or reviews of historical financial information. We call this our 'umbrella standard' for a wide variety of other limited and reasonable engagements. One case-in-point is our new standard regarding Greenhouse Gas Statements, ISAE 3410; such standard has to be used in conjunction with ISAE 3000, and we have endeavored to minimize overlap. Thinking forward, another new assurance area that might benefit from the groundwork in 3000 and 3410 is integrated reporting. This concept is still under development, but the IAASB is monitoring developments closely.

### **Progress in the Use of the Clarified International Standards on Auditing (ISAs)**

As I near the end of my presentation, I want to come back to the ISAs. Why do we have these standards? In short, I see three related drivers. First, the ISAs serve to achieve high quality audits. Second, they assist in achieving global consistency as they provide one global language for the auditing profession (both in the private and the public sector), and its regulators. Third, they thereby facilitate integration of countries into the world economy – just note the trust that is needed for foreign investments as an example.

Global standards need to be widely understandable. Their application needs to be designed proportionate in view of the size, nature and complexity of entities. That is why there are many 'Considerations Specific to Smaller Entities' in the application material of the ISAs. And their use needs to be supported by national standard setters and institutes, as well as firms.

The ISAs were thoroughly redrafted and revised during the so-called Clarity project, which finished early 2009, just when I was appointed to the Board. Since then, the IAASB has promulgated and monitored the uptake of the 'Clarified ISAs' in many jurisdictions.

Today is a special day, as I can announce that we have passed the number 100. During the preparation for this Conference we learned that we could add several African countries to the list of jurisdictions that are committed to using the Clarified ISAs. I am aware that in a few countries the use of the ISAs is not yet supported by a legal framework. Nevertheless, the accountancy institutes in such countries have instructed their members to use them anyhow, and this deserves credit. In total we now count 103 countries, and there is more in the pipeline.

An overview, grouped by continent, is as follows:

## Global Adoption of Clarified ISAs

### Jurisdictions Using Clarified ISAs Already, or Committed to Using Them in the Near Future (103)

**Europe (39):** Albania, Armenia, **Austria**, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France (Experts Comptables), FYR Macedonia, Georgia, Greece, Hungary, Iceland, Ireland, Italy, Kosovo, Latvia, Lithuania, Luxembourg, Malta, Moldova, Montenegro, Netherlands, Norway, Romania, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom

**Americas (17):** Argentina, Bahamas, Barbados, Brazil, Canada, Cayman Islands, Chile, Costa Rica, El Salvador, Guyana, Jamaica, Mexico, Panama, Puerto Rico (private companies), Trinidad and Tobago, Uruguay, USA (private companies)

**Asia and Oceania (21):** Australia, Bangladesh, China, Hong Kong, India, Indonesia, Japan, Kazakhstan, Kyrgyz Republic, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Thailand, Uzbekistan (listed entities), Vietnam

**Africa/Middle East (26):** Benin, Botswana, Ghana, Jordan, Kenya, Kuwait, Lebanon, Lesotho, Malawi, Mali, Mauritius, Namibia, Nigeria, Palestine, Rwanda, Senegal, Sierra Leone, South Africa, Swaziland, Tanzania, Togo, Tunisia, Uganda, United Arab Emirates (Abu Dhabi and Dubai), Zambia, Zimbabwe



### In Conclusion

Auditors have a key role to play in contributing to high-quality accountability and setting a basis for trust. We need to seize the global momentum for stronger corporate and auditor reporting. The ISAs contribute to that. Therefore, I am delighted to see the great progress that PAFA is making in stimulating the quality of the audit profession and its use of the Clarified ISAs.

It is now my pleasure to offer a small token of recognition of PAFA Members' contribution to the global adoption of the Clarified ISAs, now passing 100 jurisdictions worldwide, to the Vice President of PAFA, Ms Asmaa Resmouki.

Thank you for your attention.