

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York
Meeting Date: September 15–16, 2015

Agenda Item



Innovation Working Group

Objectives of Agenda Item

1. The objectives of this agenda item are to:
 - (a) Update the CAG on Innovation Working Group's¹ (Innovation WG) high-level information-gathering activities;
 - (b) Inform the CAG about developments that may have an impact on international standard setting, as identified by the Innovation WG, and obtain further input from the CAG on these topics; and
 - (c) Obtain views from the CAG as to what other developments they see as being relevant to international standard setting.
2. The discussion of this topic will follow the structure of the update presentation included as **Agenda Item I.1**.

Project Status and Timeline

3. Established in 2013, the Innovation WG has the remit of exploring emerging developments in the audit, assurance, and related services fields for the purpose of assisting the IAASB in identifying opportunities for relevant and effective standard setting, or determining other potential actions, in a timely and informed manner.
4. At their respective September 2014 IAASB meetings, the IAASB and the CAG agreed with the recommendation of the Innovation WG to establish two separate working groups for Integrated Reporting and for Data Analytics. These working groups will present separately to the CAG in **Agenda Items M and L**, respectively.
5. The Appendix to this paper provides a project history, including links to the relevant CAG documentation.

September 2014 CAG Discussion

6. A report back on comments of the Representatives on this project as discussed at the September 2014 CAG Meeting was provided at the March 2015 CAG meeting.

¹ The name of the Innovation, Needs and Future Opportunities Working Group was changed in August 2014 to the Innovation WG.

Matters for CAG Consideration

I. Topics Relevant to International Standard Setting

7. At the September 2014 Board meeting, it was agreed that after establishing the two separate WGs for Integrated Reporting and Data Analytics, the Innovation WG would keep its strategic focus on monitoring efforts on identified and emerging topics and, as appropriate, making recommendation to the IAASB in relation to these topics. In connection with its ongoing monitoring activities, it was also agreed that the Innovation WG would update the IAASB and CAG at least annually on emerging topics, including newly identified ones, and those determined to be priority topics for further attention of the Innovation WG. In addition, the Innovation WG would consider whether topic-specific background papers or presentations by subject-matter experts may be useful to further inform the IAASB and CAG about such topics as necessary.
8. It was agreed that the Innovation WG would in particular monitor:
 - (a) Assurance on non-financial information, including sustainability.
 - (b) Assurance on corporate governance reporting.
 - (c) Assurance on internal control over financial reporting, including aspects of internal control such as risk management.
9. At the December 2015 Board meeting, the Integrated Reporting Working Group was advised to expand its activities to other emerging developments in external reporting and, as such, now also covers monitoring assurance on non-financial information. With regard to related services in this area, the newly established Agreed-Upon Procedures Working Group has also included non-financial information in its scope of information-gathering activities (see **Agenda Item C**). Therefore, the Innovation WG concludes that these information-gathering activities are sufficient with respect to non-financial information.
10. The Innovation WG held two meetings in March and June 2015, and further liaised by email. They also explored which topics national auditing standard setters (NSS) have identified to be relevant to international standard setting at the May 2015 IAASB-NSS Liaison Meeting.

Assurance on Corporate Governance Reporting

11. On the topic of corporate governance reporting, various developments are noted that may impact the demand of assurance on corporate governance reporting in the future:
 - (a) In July 2015, the Corporate Governance Committee of the Organization for Economic Co-operation and Development (OECD) released its *Recommendation of the Council on principles of Corporate Governance*². The publication of the revised principles on corporate governance is scheduled in September 2015. The OECD principles are non-binding and The Principles are non-binding and do not aim at detailed prescriptions for national legislation. Rather, they seek to identify objectives and suggest various means for achieving them. They aim to provide a robust but flexible reference for policy makers and market participants to develop their own frameworks for corporate governance. Most likely these revised principles will impact corporate

² OECD Recommendation of the Council on Principles of Corporate Governance C(2015)84

governance reporting in the different jurisdictions around the world. Chapter V *Disclosure and Transparency* includes more explicitly the topics that would be disclosed in a corporate governance report. Section C addresses financial statement audits. Noteworthy for the work of the IAASB is paragraph 92 that *In addition to certifying that the financial statements represent fairly the financial position of a company, the audit statement should also include an opinion on the way in which financial statements have been prepared and presented. This should contribute to an improved control environment in the company. In some jurisdictions, the external auditors are also required to report on the company's corporate governance.*

- (b) With regard to assurance, it recommends in addition to the auditor's report on the financial statements also a conclusion on the way in which the financial statements have been prepared and presented. They note that it is expected that this will improve the control environment in companies.
- (c) The number of national jurisdictions that have corporate governance codes is increasing. Jurisdictions that already have corporate governance codes are revising their codes, for example recently in the United Kingdom. Such national corporate governance codes include requirements on transparency on the different elements of their corporate governance.³ More specific to audit committees, the Securities and Exchange Commission in the USA is considering possible revisions on audit committee disclosures. There were already requirements with regard to the role of the audit committee and their responsibilities to oversight. However there was no disclosure yet on how these responsibilities on oversight of the independent auditor are actually executed.⁴
- (d) Corporate governance codes may be endorsed via stock exchanges, such as in South Africa via the Johannesburg Stock Exchange, in addition to national regulatory or institutional frameworks.
- (e) The International Corporate Governance Network (ICGN)⁵ published its revised Global Governance Principles in 2014. ICGN is led by investors responsible for assets under management in excess of US\$26 trillion. Their mission is to inspire effective standards of corporate governance to advance efficient markets world-wide via their Global Governance Principles. Chapter seven *Reporting and Audit* explicitly includes different topics that should be disclosed to enable the investors to assess the entity's position and prospects, also other sections in the ICGN Global Governance Principles make reference to disclosing information on the particular topic discussed in that section.
- (f) United Nations Conference on Trade and Development held in 2014 a workshop discussing the future corporate reporting models⁶, bringing together representatives of different international reporting frameworks that include references to disclosing information on corporate governance. Guidance such as the International Integrated Reporting Framework of

³ See, for example, www.ecgi.org/codes/all_codes.php.

⁴ The SEC issued a concept release with the request to comment See also <https://www.sec.gov/rules/concept/2015/33-9862.pdf>

⁵ See also www.icgn.org/policy.

⁶ See also agenda UNCTAD-ISAR Workshop Future Corporate Reporting Models

the International Integrated Reporting Council. A more holistic way of reporting is starting to develop and the demand for assurance engagements on such reporting is also starting to develop.

12. When the information on corporate governance is included in the entity's annual report, ISA 720⁷ applies. An entity's annual report is described as a *single document or a combination of documents that serve the same purpose*. ISA 720 requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that there is a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor's report thereon. Paragraph 12 of ISA 720 mentions that the auditor shall read the other information and, in doing so shall (a) consider whether there is a material inconsistency between the other information and the financial statements. (b) consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit. The auditor's responsibilities under ISA 720 do not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information.
13. The Innovation WG expects that it will take time before there is a clear market demand for assurance engagements on corporate governance reporting. It may also take some time to determine to what extent such demand will develop for separate corporate governance reporting, or whether it will be on corporate governance information as part of more strategic and governance information in annual reporting, integrated reporting, or other emerging developments in external reporting.
14. As a next step, the Innovation WG plans to further consult with NSSs to obtain more insight into the potential effect the revised OECD Guidelines on Corporate Governance may have in their national jurisdictions, in particular concerning the *Disclosure and Transparency* section..

Internal Control over Financial Reporting, Including Aspects of Internal Control such as Risk Management

15. In the early nineties, different organizations issued guidance on internal control. One of the most prominent, and to date still used (including as a basis for assurance engagements on controls over financial reporting), is the guidance of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The *Internal Control-Integrated Framework*⁸ was published for the first time in 1992 with the latest revision in 2013. During recent years, there became also a need for a wider risk management approach, which resulted in the COSO Enterprise Risk Management (ERM) Framework, published in 2004.⁹ Internal control is seen in the ERM Framework as part of ERM. COSO is currently revising its ERM Framework. In addition to COSO, the International Organization for Standardization (ISO) has also developed a Risk Management Standard, ISO 31000. It was published in 2009 and is currently under revision.¹⁰ Therefore, it may be concluded that criteria that

⁷ ISA 720, *The Auditor's Responsibilities Relating to Other Information*

⁸ See also www.coso.org/ic.htm.

⁹ See also www.coso.org/-erm.htm.

¹⁰ See also www.iso.org/iso/home/standards/iso31000.htm.

are used for internal control and risk management, and used in assurance engagements, are either under revision or have recently been revised.

16. In 1995, the American Institute of Certified Public Accountants (AICPA) issued *Examination of Internal Control Over Financial Reporting* and has updated its standard since that time. Currently SSAE 15¹¹ is effective. It converges the standards practitioners use for reporting on a non-issuer's internal control with the Public Company Accounting Oversight Board's (PCAOB) Auditing Standard (AS) No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.¹² AS no.5 applies when an auditor is engaged to perform an audit of a management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements. The auditor's objective is to express an opinion on the effectiveness of the company's internal control over financial reporting. The auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment. The auditor may choose to issue a combined report (i.e., one report containing both an opinion on the financial statements and an opinion on internal control over financial reporting) or separate reports on the company's financial statements and on internal control over financial reporting.¹³
17. The IAASB does not have an equivalent standard in its suite of International Standards. As such, it was recommended at the September 2015 Board and CAG meetings to monitor developments worldwide and, in particular, the emerging demand for assurance on the broader concept of risk management.
18. Relevant national developments include:
 - In January 2015, the Australian Auditing and Assurance Standards Boards (AUASB) issued ASAE 3150,¹⁴ which is effective for assurance engagements commencing on or after January 1, 2016. This standard deals with assurance engagements undertaken by an assurance practitioner to provide an assurance report on the suitability of the design of controls to achieve identified control objectives and, if applicable, fair presentation of the description of the system, implementation of the controls as designed and/or operating effectiveness of controls as designed. It includes certain aspects of International Standard on Assurance Engagements (ISAE) 3000 (Revised)¹⁵ and ISAE 3402.¹⁶ Representatives of the AUASB gave a presentation at the IAASB-NSS meeting to inform other NSSs.
 - In Germany, a more holistic approach is used. The demand for assurance engagements comes not only from a company's management but also from the supervisory board to support them in their supervisory role. The Innovation WG noted this as a relevant development to share with

¹¹ Statement on Standards for Attestation Engagements (SSAE) 15, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*

¹² AS 5 is effective for audits of publicly traded companies in the US for fiscal years ending on or after November 15, 2007.

¹³ See AS No. 5 paragraph 86

¹⁴ Australian Standard on Assurance Engagements (ASAE) 3150, *Assurance Engagements on Controls*

¹⁵ ISAE 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

¹⁶ ISAE 3402, *Assurance Reports on Controls at a Service Organization*

the CAG and the Board and has included more details on these developments in **Section II** of this document.

19. In light of (a) increased requirements for management and those charged with governance to report on the effectiveness of internal control or their risk management function and a potential developing demand for assurance engagements (on internal control on financial reporting and risk management more broadly, (b) the different revisions of frameworks that are used as criteria in assurance engagements, and (c) developments within NSS, the Innovation WG recommends to continue its monitoring activities.

Other Topics that May Be of Relevance to Monitor

20. The feedback from NSS in May 2015 identified the following topics outside those identified already in either IAASB projects (including integrated reporting and data analytics) and those identified in paragraph 8 above:
 - (a) Cybersecurity;
 - (b) Assurance engagements focusing on compliance with laws and regulations or particular agreements; and
 - (c) Performance audits.

Cybersecurity

21. The AICPA is working on further guidance on assurance engagements with regard to cybersecurity. As the topic was highlighted also in earlier consultations with NSS and will increasingly impact the auditor, the audit firm and its clients, the Innovation WG recommends further exploration of this topic. A more elaborated overview is provided in **Section III** of this document.

Compliance Audits

22. With regard to compliance audits, different NSSs are doing further work. In Canada, the Auditing and Assurance Standards Board is developing a new Canadian Standard on Assurance Engagements (CSAE) to replace existing standards dealing with engagements to audit or review compliance with agreements, statutes and regulations, whether attestation or direct engagements. A similar development is going on within Australia at the AUASB. The Innovation WG recommends to follow these developments via updates by NSSs at the annual IAASB-NSS meeting.

Performance Audits

23. Performance audit refers to an independent examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The International Organization of Supreme Audit Institutions has published generally accepted principles of performance auditing in its implementation guidelines. At the national level, further standards have been developed such as in the Generally Accepted Government Auditing Standards, maintained by the federal Government Accountability Office of the US. Such audits are also increasingly being performed for not-for-profit organizations. In addition to government auditors or

internal auditors performing engagements, there is increasingly a demand for assurance engagements performed by external independent practitioners.

24. With regard to performance audits, different developments are noted within national auditing standards. For example:
- In Canada, a separate assurance standard dealing with direct engagements has been developed to serve as a basis for performing high-quality public sector performance audits. CSAE 3001, *Direct Engagements*, was developed with extensive input from public sector auditors across Canada (federal and provincial).
 - In New Zealand, a standard for assurance on service performance reporting was developed in response to the development of a national financial reporting standard on this topic, to be applied in both the public sector and by not-for-profit entities.
 - Feedback from the May 2015 NSS meeting also noted the AICPA's work to develop a standard for performance audits, the Japanese Institute of Certified Public Accountants; acknowledgment of increased demand for assurance engagements from the public sector as well as the not-for-profit sector, and the Chinese Institute of Certified Public Accountants' support for the Innovation WG to monitor performance audits.
25. The Innovation WG will follow these developments via updates by NSSs at the annual IAASB-NSS meeting.

II. Governance, Risk Management and Internal Control

26. Despite jurisdictional differences in legal or other arrangements, it can be noted that the responsibilities of those charged with governance are increasing. The responsibilities increase amongst others with regard to a company's risk management systems and internal control.
27. Paragraphs A1–A2 of ISA 260 (Revised)¹⁷ describe the different structures that may exist around the world for those charged with governance.
28. In Germany, the German auditing standard-setter, the Institut der Wirtschaftsprüfer (IDW), recently established a Working Group to explore how to respond to the increasing demand from supervisory boards, in particular audit committees, for assurance engagements on governance, risk management, compliance management, internal control, and the internal audit function. In Germany, all stock corporations ["Aktiengesellschaften"], which include all corporations that have shares listed on stock exchanges and most public interest entities, have a two-tier board structure with an entirely non-executive supervisory board representing shareholders and employees in addition to an executive board comprising executive directors. Many larger privately-owned limited liability companies also have such a two-tiered board structure. Under German law, the supervisory board has certain oversight responsibilities for risk management and internal control. In supporting their responsibility, the supervisory board or the audit committee thereof do request assurance practitioners to perform certain types of assurance engagements. With the exception of assurance engagements on compliance management systems, which are generally performed using the German standard for assurance engagements on compliance management systems, currently these

¹⁷ ISA 260 (Revised), *Communication with Those Charged with Governance*

engagements are often performed using (extant – as opposed to revised) ISAE 3000. However, the IDW has commenced standards setting projects to develop additional standards for these types of assurance engagements.

29. The presentation during the CAG meeting will cover the context of why IDW has initiated this new assurance project, how the project is structured and the key issues that have been identified so far.

III. Cybersecurity

30. Cybersecurity is an area on which the demand for assurance engagements is expected to increase. The demand is expected to come from a company's management, board, regulators, investors, and customers who desire an independent assessment of the company's ability to protect its systems and information. It will be an area in which both subject matter experts as well as audit firms are expected to be active. The topic of cybersecurity also links to the IAASB project on data analytics as, to enable performing new and advanced data analytics techniques, the continuous availability of data needs to be secured.
31. The principal objective of cybersecurity is to reduce the risks, including prevention or mitigation of to protect the cyber environment of a user or organization against cybersecurity attacks, damage or unauthorized access. This environment includes users themselves, networks, devices, all software, processes, information in storage or transit, applications, services, and systems that can be connected directly or indirectly to networks. Ensuring cybersecurity requires coordinated efforts throughout an information system. Elements of cybersecurity include:
- (a) Application security;
 - (b) Information security;
 - (c) Network security;
 - (d) Disaster recovery/business continuity planning; and
 - (e) End-user education.
32. Different organizations have already developed guidelines for the design of the body of technologies, policies, security concepts, risk management processes and security safeguards, training and other practices needed designed to protect networks, computers, programs and data from attack, damage or unauthorized access.¹⁸
33. One of the most problematic elements of cybersecurity is the quickly and constantly evolving nature of security risks. The traditional approach has been to focus most resources on the most crucial system components and protect against the biggest known threats, which necessitated leaving some less important system components undefended and some less dangerous risks not protected against. Such an approach is insufficient in the current environment. To deal with the current environment, advisory organizations are promoting a more proactive and adaptive approach. The US National Institute of Standards and Technology, for example, recently issued updated guidelines in

¹⁸ See the National Institute for Standards and Technology

its risk assessment framework that recommended a shift toward continuous monitoring and real-time assessments.¹⁹

34. Also professional accountants, their organization and clients will be at risk to cybersecurity. The Center for Audit Quality issued in 2014 in advance of a workshop by the Securities and Exchange Commission on cybersecurity an alert describing the responsibilities of the auditor of financial statements and how cybersecurity in the context of Information Technology is taken into account.
35. In the ISAs the risks of cybersecurity are not explicitly addressed, but implicitly included in the ISAs, in particular ISA 300 and ISA 315.²⁰ In planning of the audit of financial statements and identifying the risks of material misstatement the auditor obtains an understanding of any significant business developments that may impact the entity, including the changes in information technology. The auditor also obtains an understanding of the information system relevant to financial reporting, including the procedures and controls around and within such systems. In particular the application material to ISA 315 describes internal controls around and within information systems, including the information technology, in detail.
36. The AICPA has established a working group that is that has been assigned responsibility for developing guidance for cybersecurity attestation engagements. This guidance is expected to be published by summer 2016 to enable management provide accountability for their cybersecurity program. The working group is currently developing guidance on how management can describe its cybersecurity operations, including its position, results of operation of the program and internal controls around cybersecurity. The project also plans to address the criteria to be used to assess the management's description.
37. The presentation will cover the context of why AICPA has initiated this new assurance project, what will be covered by the project and some key highlights of the guidance that will be developed.
38. **Agenda Item I.1** includes a presentation on the work of the Innovation WG, some background on its exploration activities and some background on the topics the Innovation WG intends to obtain further views on from the CAG as also described in section II and III above.

Matters for CAG Consideration

1. Representatives are asked for their views on the two areas identified in Sections II and III and to what extent the Innovation WG should continue to monitor them in light of international standard-setting needs.
2. Representatives are asked to provide input on any other relevant developments they see as being relevant to the work of the Innovation WG.

Material Presented – IAASB CAG PAPER

Agenda Item I.1

Presentation – Update on the Innovation WG

¹⁹ See also www.thecaq.org/docs/alerts/caqalert_2014_03.pdf?sfvrsn=2.

²⁰ ISA 300, *Planning an Audit of Financial Statements* and ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*

Project History

Project: Innovation WG

Summary

	CAG Meeting	IAASB Meeting
Preliminary Discussions	March 2012	March 2012
Approval of Terms of Reference of Innovation WG	April 2013	April 2013
Updates / Briefings	March 2014	March 2014 June 2014
Discussion on Proposed Way Forward	September 2014	September 2014
Report Back to the CAG	March 2015	N/A
Update on monitoring activities	September 2015	September 2015

CAG Discussions: Detailed References

Preliminary Discussions	<p><u>March 2012</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20120306-IAASBCAG-Agenda_Item_D-Strategy_Report_Back-v1-02.pdf</p> <p>See CAG meeting minutes (in Agenda Item D of the following): http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_A_March%202012_Public%20Minutes-APPROVED.pdf</p>
Approval of Terms of Reference	<p><u>April 2013</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20130403-IAASB-CAG-Agenda_Item_G-3-INFO_TOR-final.pdf</p> <p>See CAG meeting minutes (in Agenda Item G of the following): http://www.ifac.org/sites/default/files/meetings/files/April%202013%20IAASB%20CAG%20Public%20Minutes%20a%20Approved.pdf</p> <p>See report back on April 2013 CAG meeting at Agenda Item J.2: http://www.ifac.org/sites/default/files/meetings/files/20130909-IAASB-CAG-Agenda_Item_J2-Strategy_Report_Back-Final.pdf</p>
Updates / Briefings	<p><u>March 2014</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20140311-IAASBCAG-Agenda_Item_D-INFO_Integrated_Reporting-Cover-final.pdf</p>

	<p>http://www.ifac.org/sites/default/files/meetings/files/20130411-IAASBCAG-Agenda_Item_D1_INFO_WG_Presentation_WideScreen-final.pdf</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20140311-IAASBCAG-Agenda_Item_D2-INFO_Integrated_Reporting_and_Assurance_Briefing_Paper-final.pdf</p> <p>See CAG meeting minutes (Agenda item D):</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20140908-Agenda_Item_B-IAASB_CAG_March_2014_Meeting_Minutes_Marked_for_CAG_Rep_Feedback-final.pdf</p> <p>See report back on March 2014 CAG meeting:</p> <p>http://www.ifac.org/system/files/meetings/files/20140908-IAASB_CAG-Agenda_Item_E-Innovation_WG_Report_Back_Cover-final.pdf</p>
	<p><u>September 2014</u></p> <p>See IAASB CAG meeting material:</p> <p>http://www.ifac.org/system/files/meetings/files/20140908-IAASB_CAG-Agenda_Item_E-Innovation_WG_Report_Back_Cover-final.pdf</p> <p>http://www.ifac.org/system/files/meetings/files/20140908-IAASB_CAG-Agenda_Item_E.1-Innovation_WG_Presentation-final.pdf</p> <p>See CAG meeting minutes (Agenda item E):</p> <p>http://www.ifac.org/system/files/meetings/files/2015-03-09-Agenda_Item_A-Draft-IAASB_CAG_Sept_2014_Public_Session-Meeting_Minutes-Marked_from_CAG.pdf</p> <p>See report back on September 2014 CAG meeting:</p> <p>http://www.ifac.org/system/files/meetings/files/20150309-Agenda_Item_E-Innovation_WG_Report_Back_Issues-final.pdf</p>
	<p><u>March 2015</u></p> <p>See IAASB CAG meeting material:</p> <p>http://www.ifac.org/system/files/meetings/files/20150309-Agenda_Item_E-Innovation_WG_Report_Back_Issues-final.pdf</p> <p>See CAG meeting minutes: N/A</p> <p>See report back on March 2015 CAG meeting: N/A</p>