

Directions in Auditing & Assurance: Challenges and Opportunities

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It is a great pleasure to be here with you in Australia. One small reason is that this region holds personal meaning for my immediate family and me. More importantly, however, it is because Australia has made many significant contributions to the IAASB over the years. At present we have the pleasure and benefit of Australian representation by Ms. Merran Kelsall and Ms. Caithlin McCabe as Board members, and Mr. Richard Mifsud as Technical Advisor. Before them, Mr. Ian McPhee and many others have also participated in the long and fruitful history of the IAASB. As always, there has and continues to be, much support given to the work of the IAASB by the Australian Auditing and Assurance Standards Board, and the national accounting bodies.

AUASB Chairman Ms. Kelsall has invited me to speak about current and future directions in auditing and assurance, and related challenges and opportunities.

Clarified ISAs

Let me start by referring to the Clarified International Standards on Auditing (ISAs). Why? They hold much relevance to how the audit profession can better work in providing quality audits in the public interest.

The Clarity project was the central focus of the IAASB's work up to 2009. In part, it was a response to the call for high-quality standards that can act as a further catalyst to international convergence. It was also, in some respects, a proactive response to regulatory concerns now being identified. The Clarified ISAs reinforce the concepts of professional judgment and skepticism and promote what we call the "thinking audit"—an appeal to auditors to use their brains rather than simply aim to achieve compliance with a set of rules.

Who's using the Clarified ISAs? I congratulate both Australia and New Zealand for their early adoption of these standards. Internationally, more than 80 jurisdictions use, or are committed to using soon, the Clarified ISAs. This includes 21 of the 27 Member States of the European Union and many other countries across Europe; it is equally true for Asia, Africa and the Americas. In addition, 24 global auditing networks use ISAs as the basis for their audit methodology. The IAASB also welcomes the support shown by securities regulators, the public sector, and professional bodies, amongst others, that have helped make the ISAs the common language for audits across all entities, large and small, public and private. However, notwithstanding this success, our work is far from being done.

The Challenges to the Relevance of Audit

There has been revolutionary change in financial reporting over the last two decades, particularly in terms of how financial information is communicated. Take financial statement disclosures as an example. Today, relevant disclosures are made both in and outside of the financial statements, and they have become increasingly qualitative in nature. In the past, it could have been said that financial statements comprised many numbers with a few words to explain them; now it is the words—in many cases, literally hundreds pages of narrative disclosure—that are the focal point of readers. This change poses practical challenges for both preparers and auditors.

More broadly, the global financial crisis has also produced questions about the relevance of the audit and the trust in the audit profession. For example, the UK Treasury Select Committee noted the following:

“We have received very little evidence that auditors failed to fulfill their duties as currently stipulated. The fact that some banks failed soon after receiving unqualified audits does not necessarily mean that these audits were deficient. But, the fact that the audit process failed to highlight developing problems in the banking sector does cause us to question exactly how useful audit currently is. We are perturbed that the process results in “tunnel vision,” where the big picture that shareholders want to see is lost in a sea of detail and regulatory disclosures.”¹

Thus, we have questions about the quality of auditing—are auditors effective? Are they exercising professional judgment? Are they applying a “healthy dose” of professional skepticism? In the US, and Europe, for example, these questions have prompted a round of regulatory proposals around auditor reporting, audit committees and, audit firm rotations.

So, we must ask ourselves: *Is auditing relevant in providing what society needs? And what can we contribute to enhance that?*

The IAASB’s response to this challenge includes many aspects of its work, but tonight I highlight just three: Auditor Reporting, Audit Quality and Disclosures.

Auditor Reporting

The IAASB’s number 1 priority is to improve the auditor’s report. Why? The auditor’s report is the only tangible part of the audit that the world sees. So it goes without saying that it is critical that the auditor’s report be as informative, as relevant, and as meaningful to users as possible. But, we have learned that while users value the audit, they find that the auditor’s report itself lacks communicative value. The increasing complexity of financial reporting has spurred users to want to hear more from the auditors about the audited financial statements, and more about the audit itself.

The IAASB’s work to date has included the commissioning of research in 2006 on users’ perceptions of the auditor’s report. This was followed by the IAASB consultation paper in 2011 entitled, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*. In June of this year, we issued an Invitation to

¹ UK Treasury Select Committee, *Banking Crisis: reforming corporate governance and pay in the City*, May 2009.

Comment (ITC), titled *Improving the Auditor's Report*, which seeks comment on the IAASB's indicative direction for changes to the auditor's report in advance of an exposure draft in 2013.

What might the auditor's report of the future look like? Looking at the illustrative report in our ITC, the most relevant information to the user, the auditor's opinion, is positioned first. More substantial, however, is a new section referred to as "Auditor Commentary." Such a section would have the auditor communicate matters that, in the auditor's judgment, are most important to users' understanding of the audited financial statements and/or the audit. The IAASB's proposals also include new communications on Going Concern and Other Information, together with improvements to better explain an audit of financial statements and enhance transparency.

To facilitate further input, we have organized two roundtables already, in New York, USA and Brussels, Belgium, with the final roundtable to be held in Kuala Lumpur, Malaysia soon. The IAASB is keen to hear from all stakeholders about the possible direction outlined in the ITC.

While these improvements have the potential to add a greater degree of relevance and value to the auditor's report, they also hold a number of challenges. For example, audit committees will need to consider what processes and dialogue are necessary when discussing with the auditor the information that is to be included as "auditor commentary" in the auditor's report. Auditors themselves will have challenges in formulating such comments, and it may be that we can learn from public sector auditors who have experience with public longer form reports.

Nevertheless, these are vital areas if we want to improve the auditor's report and make it more relevant. So the salient question becomes: *How can we best prepare for challenges and opportunities to users, audit committees, preparers, and auditors arising from changes in auditor reporting?*

Audit Quality

Ask most readers of audited financial statements and the auditor's report about: "audit quality" and it will become clear that they will not know much. But, audit quality is a matter of relevance to all stakeholders, and everyone has a role to play in helping to improve it.

The inputs to audit quality such as training, ethics, auditing standards, and quality controls are essential, as is the professional judgment and skepticism that the auditor brings to bear to each audit engagement. However, we know that the outputs of the audit process also influence audit quality, and perceptions of audit quality. For example, the auditor's report is vital for users' understanding of the quality of an audit. Equally important, there are the interactions between participants in the financial reporting process. For example, an engaged audit committee can help stimulate the auditor to deliver a high-quality audit.

Ten years ago, a discussion of audit quality might have stopped here. But, more broadly, there is now also what we refer to as 'context factors—corporate governance frameworks, regulation and legislation, and oversight and inspection regimes—all of which have important influences on audit quality. This increases substantially the importance of interactions between the various stakeholders to audit quality.

Our work on this important topic is moving forward quickly. By December this year, we anticipate approving for public consultation a proposed international Audit Quality Framework. We hope such a Framework will be a contribution welcomed by all quarters, and serve to stimulate broader discussions on the topic. At the heart of this initiative is the question that we all must continue to ask ourselves: “*What further role could the profession, regulators, preparers and users play in promoting and protecting audit quality?*”

Disclosures

As I mentioned at the outset, financial reporting is rapidly evolving. Addressing the challenges that this poses requires a holistic approach involving accounting and auditing standard setters, regulators, investors and preparers.

While the auditor’s opinion is on the financial statements as a whole, let me narrow in on the topic of disclosures. In today’s reports, there are many important disclosures; some factual, but also many that are judgmental in nature. The natural questions that arise include whether all disclosures are being audited in the same way, and should they be? Is materiality the same for all the different types of disclosures? And should auditors help ensure that disclosures focus on the right information in the right amount of detail; if so, how?

The IAASB of course has a role to play in seeking answers to these and other important questions, and has in September approved commencement of a new project addressing the audit implications of disclosures. As part of this initiative we will actively liaise with the IASB and others, including providing our input on auditability issues.

In relation to disclosures outside of the financial statements, at its September 2012 meeting the IAASB approved for exposure a proposed revised standard addressing the auditor’s responsibilities relating to disclosures outside of the financial statements, known as “other information.” Auditors have responsibility to read those disclosures, and we propose enhancing this responsibility as there is much that the auditor can bring to bear in light of the auditor’s understanding of the entity, and its environment acquired during an audit.

All of the above is part of finding answers to the question that virtually every reader of audited financial statements is asking: “*How can auditors and others in the financial reporting process assist in improving the quality and understandability of disclosures?*”

Opportunities in Assurance and Services Other Than Audits

Now, let me turn briefly to other important opportunities that cannot be overlooked.

As we all know, audits of financial statements are not the only assurance service available. And for many smaller entities, other assurance and related services may be more relevant. The IAASB has made several efforts to address this important constituency and their unique needs.

Firstly, we issued a staff publication on making clear how to use the ISAs proportionately with the size and complexity of the business. Secondly, we issued a revised standard on compilation engagements—which is particularly useful when smaller entities need professional assistance with preparing their financial statements. Thirdly, our revised standard on review engagements released in September 2012, is particularly useful when audits are not mandated, and a lesser amount of assurance is needed. Finally, in 2013, we aim to start our revision of our standard on agreed-upon procedures, which will further enhance the suite of standards that support high-quality services to smaller entities and others.

More broadly, the IAASB also acknowledges the need to embrace innovation and stay abreast of new ideas and issues. Our recent new standard addressing assurance on Greenhouse Gas Statements is an example of the Board's commitment to developing standards addressing emerging fields of reporting, and doing so in an innovative way. But, as always, there is more to be done.

To this end, we are setting up a group to identify and research issues of relevance to the IAASB's future work. A key component of this effort will be developments in integrated reporting, a topic we see much interest, early thinking, and progress being made here in Australia. The overall question that we are therefore asking ourselves, and which all stakeholders must have in mind, is: *"How should we best prepare for assurance needs that may arise as a result of new kinds of reporting?"*

Closing

For me, the challenges and opportunities in setting international auditing and assurance standards offer a similar lesson to that which I learned in my modest efforts in mountaineering. Simply put, once you reach the peak you have a short opportunity to look around, to have great perspective on where you have come; but then the only relevant consideration is: *"What next?"* Well, no time for relaxation, but the more for concentration on new directions!

In my remarks I have indeed raised more questions than answers. But, that is the essence of looking to the future, walking through partially uncharted territory. I look forward to a future of open, constructive and productive dialogue on an international basis.

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