

Future of Audit & Financial Reporting

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Agenda

Future of audit & financial reporting

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- **Background**
 - **Globalisation and political intervention**
 - **The value of an audit**
 - **Usefulness of financial information**
 - **The challenge to the profession**

Background

Audit and accounting evolves in response to changes in the *economy*

- **Context is *the global economy***

Background

A long history of '**harmonisation**' pre 1980s

Accelerated by **convergence** (1990s) and **adoption/globalisation** (2000s)

Impacts:

Corporations' legislation and regulation including process for setting standards for auditing, accounting and ethics

ONE WAY

Background

Major corporate collapses in the last decade have led to the decline or elimination of self-regulation by the accounting profession.

- Enron, WorldCom, Lehman Brothers, Satyam

The collapses raised questions & concerns:

- Accounting – off balance sheet vehicles
- Audit – due process, fraud, reporting
- Ethics – what happened??

Background

Heightened political pressure

- **G20 - significant influence on the international financial reporting agenda**
- **European Commission - claiming the role as global leader in the field of auditing**

Background

Increasing debate about the relevance of information in financial reports

- **Increasing debate on the so-called reforms proposed in exposure drafts**
 - IAS 39; Revenue from contracts with customers; Leases
- **Length of time to issue an international standards is considerable**
 - Next wave issued standards from 1 January 2013
 - Next wave re current exposure drafts *expected* 2015

Background

Focus on financial reporting by listed companies over the past decade

- **Global financial reporting standards for privately owned entities has been neglected**
- **Private business – the backbone of many economies**

Background

Complex accounting framework sets context for the audit of the financial report

- Subjective judgments
- Management bias

Concerns over audit process

- Auditor independence
- Rigour
- Professional judgement and scepticism
- **Revised reissued Clarity ISAs**
- **Regulatory oversight**

Background

Audit requirement for non-listed entities is now considered too onerous

- **Search for alternative services has commenced without proper recognition of the value of an audit**

Background

Nonetheless, the adoption of international financial reporting standards and international standards on auditing continues across new jurisdictions.

The future for audit and accounting will be shaped by the responses to these challenges.

OECD Principles of Corporate Governance 2004

The state's role in corporate governance is necessary for the efficient functioning of the economy

The state has the following functions with respect to corporate governance:

Institution building

Legislative reforms

Law enforcement



Source: OECD Principles of Corporate Governance, 2004
Organisation of Economic Co-operation & Development

OECD Principles of Corporate Governance 2004

Focus on publicly traded companies

Also acknowledged as a “useful tool to improve corporate governance in non-traded companies, for example, privately held and state-owned enterprises.”

Challenge:
***Does one size
fit all?***

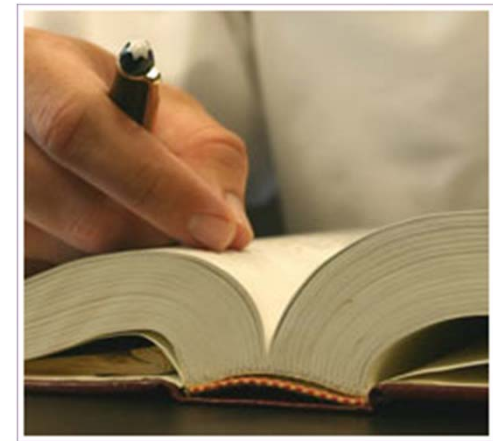


Source: OECD Principles of Corporate Governance, 2004
Organisation of Economic Co-operation & Development

Political intervention

OECD Principles of Corporate Governance 2004 has promoted governance at state level – principles are converging in jurisdictions around the globe.

Principles are enforced through corporations' legislation and regulatory oversight.



Political intervention

Professional accounting bodies have lost the ability to self-regulate in many jurisdictions.

Standard setting is required to be independent of preparers/users.

Significant influence of governments and G20 demonstrated in responses by standard setting bodies to GFC.



International Forum of Independent Audit Regulators (IFIAR)*

Shares knowledge of the audit market environment and practical experience of independent audit regulatory activity



Promotes collaboration in regulatory activity; and

Provides a focus for contacts with other international organisations which have an interest in audit quality.

* Formed 15 September 2006

IFIAR – member countries

Abu Dhabi
Australia
Austria
Brazil
Bulgaria
Canada
Denmark
Dubai
Egypt
Finland
France
Germany
Greece

Hungary
Ireland
Italy
Japan
Korea
Lithuania
Luxembourg
Malaysia
Malta
Mauritius
Netherlands
Norway

Singapore
Slovak Republic
Spain
Sri Lanka
Sweden
Switzerland
Chinese Taipei
Thailand
Turkey
UK
USA



IFIAR

Observers:

Financial Stability Board

Public Interest Oversight Board

International Organization of Securities Commission

Basel Committee of Banking Supervisors

International Association of Insurance Supervisors

World Bank

European Commission

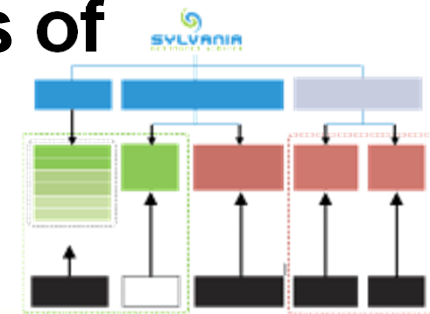


Impact on group audits [ISA 600]

Competence of component auditors is determined by the regulatory environment in which it operates.

Adequacy of regulatory oversight (is the jurisdiction a member of IFIAR?)

Impacts on ability of auditors in SMPs to audit smaller local subsidiaries of multinational corporations



Current trends in audit

IAASB* is influenced by:

- **PCAOB (US)**
- **European Commission**
- **IOSCO and IFIAR**
- **Local standard setters**



* International Auditing and Assurance Standards Board

Current trends in accounting

IASB* is influenced by:

- **Governments - G20**
- **World Bank**
- **IMF**
- **Local standard setters**



Financial crisis

What are the differences?

Significant differences in stage of development of jurisdictions around the globe

Contrast established, mature, declining markets with vibrant, growing businesses in the new economies

Contrast focus on capital markets with the emergence of business prosperity through economic growth in the SME sector

Standard setters are responsive but they are not hearing enough about the needs of our growing economies



The value of an audit

Regulators focus on independence as being the driver of audit quality. Focus on a fundamental input not on different quality of output.

Media focuses on costs – attracting regulatory concern.

Little attention is given to demonstrating the *value added* through the audit function.



The value of an audit

Risk-based methodologies are concerned with examining governance practices.

Good governance is concerned with promoting efficiencies for better performance and risk mitigation.

Good governance is essential for growing businesses.



The value of an audit

Good governance practices in young emerging businesses do not follow the same structure as governance in multinationals.

Structure may be less formal but just as essential for promoting good business health.



Adapted from Internal Control-Integrated Framework, COSO

Auditors of SMEs understand the internal controls needed in growing business and can recommend effective processes that are not onerous.

Audit and business performance

Audit is concerned with examining business performance and making recommendations where significant deficiencies exist.

Requirements of auditing standards are scalable and entirely appropriate for smaller entities.

Hurdle? Need to accept documentation requirements.



Current developments in audit

Audit concentration is of primary concern

European Commission

House of Lords

“Status quo is not an option”

Mandatory tendering of audits

Rotation of audit firms

Joint audits

Prohibition of non-audit services to listed entities

Audit services for non-listed entities?



Current developments in audit

The IAASB is already developing standards for audit-related services for SMEs (maybe non-listed entities?)

- Independent reviews by practitioners
- Compilations



REVIEW

These services do not examine governance practices and have limited benefit for growing businesses.

- Concerned only with reliable information.

Usefulness of financial information

Adoption of IFRS is proving problematic in many jurisdictions.

Complex, lengthy financial statements based on economic concepts may be difficult to understand.

Authority of the IASB remains questionable

- US convergence is slow
- European Commission criticisms



Complex transactions

Complex transactions *cannot* be explained by simple historical cost accounting

Reliable financial information to explain financial performance in these transactions is needed to make sound *economic* decisions

Economic performance forming the basis for IFRS is needed to explain allocations of revenue and cost in complex transactions

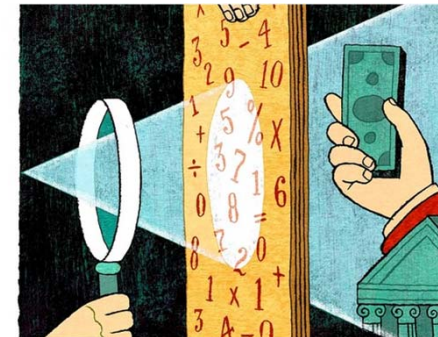
Usefulness of financial information

As businesses grow it is more likely that they will enter into complex transactions

A knowledge of accounting under IFRS is essential *unless/until the IASB loses its authority.*

Preferable to gain an understanding of economic performance to be able to explain the IFRS information.

Most relevant for complex transactions when the “value” in a transaction may not be transparent.



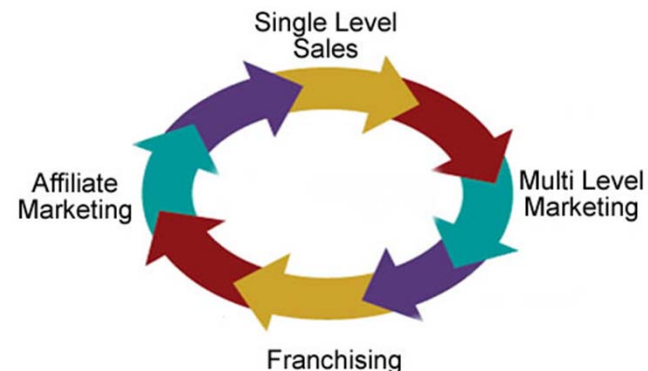
Usefulness of financial information

IFRS calculations should be supported by good internal management practices

Reliability of budgets and forecasts

Performance monitoring of products/segments

Alignment of reporting with the entity's business model



Usefulness of IFRS

Preferable if the examination of IFRS reporting adds value through recommendations for improved internal governance processes

IFRS practices aligns closely with a risk-based audit approach

- Business model
- Business risks
- Performance reporting



Auditors should add value

Compliance for statutory reporting should not detract from the auditor's ability to comment on information used for monitoring business performance internally



Issues impacting the future

US convergence/adoption of IFRS

- Decline of the US economy and global leadership role

The continuing *influence* of the IASB

The continuing *influence* of the IAASB

The strength of the EU

- Economically and as (global) standard setters

The strength of the emerging economies

- Economically and as (global) standard setters

Australian example

– liaison with profession

Understand thinking of other lobbyists and influence where possible:

- **Members of Committees of Professional Accounting Bodies**
- **Member of professional groups with Big 4 technical partners**
- **Chair of large national network group**
- **Member of AICD* reporting committee**

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* Australian Institute of Company Directors

Australian example

– liaison with regulators

Promote understanding of particular market segments (including private business)

Board member of AUASB*

Member of IAASB task forces

Regular meetings with:

- **Financial Reporting Council chair**
- **Treasury representatives**
- **Chief accountant at ASIC – company and auditor regulator**
- **IASB board members when visiting Australia**
- **Chairman of AASB****

* Australian Auditing and Assurance Standards Board

** Australian Accounting Standards Board



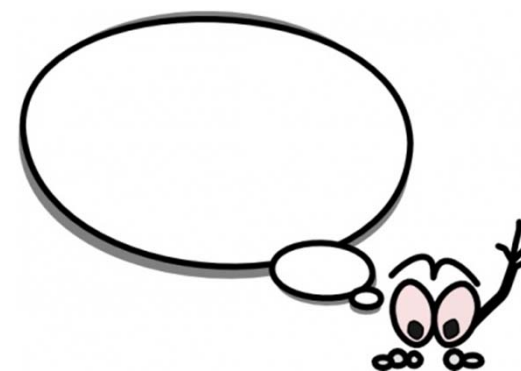
What does this mean for local jurisdictions?

Economic governance is determined by the rigour in regulatory oversight

- Impacts overseas investment?

Rigour of regulatory standards is by reference to international standards

Participation by local accounting bodies is imperative for international standards to be internationally relevant



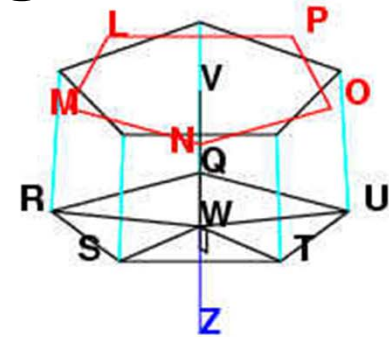
Current trends in audit & accounting

Three approaches:

Local regulators resist global regulatory pressure [Is this feasible?] OR

Accept what is pushed down from international standard setters adopting a 'wait and see' approach OR

Proactive involvement to *shape* the thinking of international standard setters and local regulators to focus on what is good for our local economies



Challenge to shape current trends

Professional accountants can reclaim leadership for audit and financial reporting by providing a meaningful contribution to the evolution of audit and accounting

(Or choose to become facilitators)

As members of an important and vibrant profession we have both the right and the responsibility to participate effectively