

The Institute of Chartered Accountants in Australia

Audit Conference 2009

The Future of Audit

Melbourne 1 May, 2009

With thanks to Dr Stewart Ashe and Kevin Caruana of ANAO
for their assistance with the preparation of this paper

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INTRODUCTION

On one view, auditing is a mature profession. It has a long history, going back to at least the 14th century, where the records of chamberlains and town treasurers were subject to audit by external officers. The importance of auditing grew with the expansion of commerce, the birth of the limited liability company and the rise of the stock markets in the early 1600s, as arrangements then applying empowered stockholders to employ auditors to check the accounts.

Auditing has developed since then, been given statutory support and is arguably more important today than ever before. With the growth in commerce, the complexity of business structures and financial transactions, and the level of uncertainty in today's world, the importance of assurance in relation to financial reporting and other critical business activities has never been greater.

Today, the scale of the financial world is immense:

“In 2006 the measured economic output of the entire world was around \$47 trillion. The total market capitalisation of the world's stock markets was \$51 trillion, 10 per cent larger. The total value of domestic and international bonds was \$68 trillion, 50 per cent larger. The amount of derivatives outstanding was \$473 trillion, more than 10 times larger..... Every month seven trillion dollars change hands on global stock markets.....And all the time, new financial life forms are evolving. In 2006, for example, the volume of leveraged buyouts (takeovers of firms financed by borrowing) surged to \$753 billion. An explosion of ‘securitisation’ ... pushed the total annual issuance of mortgage backed securities, asset-back securities and collateralised debt obligations over \$3 trillion. The volume of derivatives...has grown even faster¹... New institutions [*such as hedge funds and private equity partnerships*] too, have proliferated.²

The global financial crisis has seen growth in the economies of many countries go negative, with some expectations of a turnaround towards the end of 2010. The OECD forecast prepared for the G20 summit in London is that, bearing in mind the “exceptionally large” uncertainties inherent in the current climate, a “policy-induced recovery will gradually build momentum through 2010” with world real GDP growth falling by 2¼ per cent this year and recovering by 1¼ per cent in 2010.³

In such a world, the importance of auditing is paramount because of the independent assurance provided to recipients of audit and related reports. That confidence relies on the auditing profession ensuring the standards we apply, including ethical standards, are high quality and implemented effectively in reaching audit conclusions.

The Advisory Committee on the Auditing Profession to the United States Department of the Treasury emphasised the importance of the auditing profession in the following way:

“Ultimately, it is a combination of transparency and trust that enables our financial markets to function efficiently. A strong and vibrant auditing profession is a critical element of that regime...”⁴

The great strength of the auditing profession is, in my view, its assurance framework and standards which are contemporary, soundly based, and adaptable for other assurance work. The other important complement to this is that the profession is governed by an interconnected global body (the International Federation of Accountants or IFAC) that is able

to steer the profession through the issues and turbulence that will inevitably occur from time to time.

As for the challenges, they are not new: they centre on the effective implementation of the standards and the evergreen issue of how to cogently communicate to stakeholders the auditor's role and responsibilities to limit any expectation gap.

In my presentation today, I plan to

- discuss the profession's strategic investment in standards,
- refer to the expansion of opportunities for assurance providers, and
- mention some of the challenges for the profession as well.

STRATEGIC INVESTMENT IN STANDARDS

Background

When I was a student, one of my auditing text books, *"The Philosophy of Auditing"* by Mautz and Sharaf, contained an extract from a report of a committee of English experts in 1942 in discussing the future of auditing in Britain at that time:

"Attempts to persuade the accountancy profession to take a wider view of their public responsibilities have so far met with little success. . . there is little or no evidence during the last twenty or twenty-five years to show that the professional accountant, qua professional accountant, has produced a single idea of value to industry or the State. He has merely ticked and cast and trusted in God."⁵

Mautz and Sharaf were giving encouragement to the development of a theory of auditing, observing that:

"For years auditing has been so busy getting itself established and accepted that it has had little time for such introspection. But as it becomes more and more mature, this excuse becomes less and less valid. There is indeed something incongruous about a profession with no visible support in the form of a comprehensive and integrated structure of theory. We need a philosophy of auditing."⁶

Even today, despite the maturity of the profession, we do not have an accepted philosophy of auditing or conceptual framework, although there is an agreed framework for assurance engagements to guide the development of standards and practice statements.

The International Auditing and Assurance Standards Board (IAASB) of IFAC considered the development of a conceptual framework in recent times but has put the idea aside, being cognisant of other priorities and knowing the level of resources that would be involved to reach an agreed position.

Rather, the recent focus of the IAASB has been on clarifying, and in some cases, revising, the full body of auditing standards. Before referring to the work of the IAASB, I would like to mention a story about Enron, which appears in the book *"The Smartest Guys in the Room"* by Bethany McLean and Peter Elkind,⁷ to underline the importance of the quality of auditing standards, and audit performance.

In the book, a former Enron accountant admits:

"We tried to aggressively use the literature to our advantage. ... All the rules create all these opportunities. We got to where we did because we exploited that weakness".

Another former employee described the process as follows:

"Say you have a dog, but you need to create a duck on the financial statements. Fortunately, there are specific accounting rules for what constitutes a duck: yellow feet, white covering, orange beak. So you take the dog and paint its feet yellow and its fur white and you paste an orange plastic beak on its nose, and then you say to your accountants, 'This is a duck! Don't you agree that it's a duck?' And the accountants say, 'Yes, according to the rules, this is a duck.' Everybody knows that it's a dog, not a duck, but that doesn't matter, because you've met the rules for calling it a duck."

This story carries a salutary message for accountants and auditors, and underlines why it is important for the profession to have high quality standards that have been developed in the public interest. Much has been done by the profession, internationally and nationally, to strengthen the body of standards since the Enron era at the start of this decade.

The profession also relies on academic research to inform the development of standards. In this context, I wish to draw your attention to a significant research report being prepared by the Australian National Centre for Audit and Assurance Research of the Australian National University that is due to be released shortly. The research, which has been supported by The Institute of Chartered Accountants and CPA Australia, amongst others, is concerned with "Keeping Capital Markets Efficient: A National Strategy on the Future of Auditing".

Global auditing standards

The profession's engine room for the development of auditing and assurance standards is the IAASB, an independent standard-setting board within IFAC. It had its origins in March 1978 as the International Auditing Practices Committee, began issuing standards rather than guidelines in 1991, was re-named in 2001 following a major review of its membership and processes, and was further strengthened as a result of a major IFAC revamp of IFAC's standards-setting processes in 2003.⁸

The IAASB's objective is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.⁹

The IAASB's International Standards on Auditing (or ISAs) are intended for use in all audits — publicly traded companies, private business of all sizes and government entities at all levels.

There is increasing support for a global set of auditing standards. Over 100 countries are using or are in the process of adopting or incorporating the ISAs into their national auditing standards or using them as a basis for preparing national auditing standards. The significant majority of the world's largest capital markets accept ISAs for the audit of the financial statements of foreign issuers. Further, ISAs now incorporate public sector considerations and are used as the basis for financial auditing guidelines promulgated by the International Organisation of Supreme Audit Institutions (INTOSAI), representing 189

external auditors of governments. They also include considerations for the audit of SMEs, and the IFAC Small and Medium Practices Committee has produced a “Guide to Using International Standards on Auditing in the Audit of Small- and Medium-sized Entities” upon which the Institute’s *The Australian Auditing Manual* is based.¹⁰

In Europe, the European Commission is establishing a platform to allow the adoption of ISAs, as part of a comprehensive directive on statutory audits.¹¹ A report on the financial crisis to the President of the EU in September 2008 recommended that Europe adopt ISAs as soon as possible to reduce uncertainty and promote convergence¹².

One jurisdiction where ISAs are not yet accepted is for public company audits in the United States of America. You will recall that the high-profile company collapses in the US around the start of the decade led to the introduction of the *Public Company Accounting Reform and Investor Protection Act of 2002* (commonly called Sarbanes-Oxley) as a federal law enacted on July 30, 2002.

That Act gave responsibility for setting auditing standards for public company audits to the Public Company Accounting Oversight Board (PCAOB). Up to that time, private sector auditing standards in the US were the province of the Auditing Standards Board (ASB) of the AICPA, which retains its role for non-issuers and which has been committed to basing its standards on ISAs since 1998.

The Sarbanes-Oxley Act includes provisions requiring non-U.S. audit firms that audit U.S. public companies (including foreign private issuers) to register with the PCAOB and undergo regular inspections. The PCAOB has working relationships with its counterparts in other countries in connection with the inspection of non-U.S. firms registered with the PCAOB. As at December 2007, the PCAOB had conducted inspections in approximately 20 jurisdictions, including Australia.

While the idea of common auditing standards might be some way off, some important steps and arrangements towards convergence of standards are in train.¹³

The PCAOB’s Strategic Plan 2008-13, under the general goal of taking “a leadership role in international efforts to improve auditor oversight and auditing practices worldwide and reduce duplication of effort” commits the PCAOB to “examine the implications for the PCAOB’s mission of multiple auditing standards and varying audit environments across global capital markets and consider how the Board should respond.”

The PCAOB has an observer role at meetings of the IAASB. And now, in each of the PCAOB’s standards-setting projects, the PCAOB monitors the work of the IAASB and the ASB to leverage best practices and other auditing enhancements. In October 2008, the PCAOB for the first time included an extensive comparison of proposed new standards with the relevant ISAs – being in this instance the auditing standards related to the auditor’s assessment of and response to risk.¹⁴

Further, on the convergence of auditing standards, the CEOs of six international audit networks, including the Big 4, released a paper in November 2006, titled *Global Capital Markets and the Global Economy – A Vision from the CEOs of the International Audit Networks*. In that paper, the CEOs sought to begin a dialogue about how global financial reporting and public company auditing procedures needed to adapt to better serve capital markets around the world. They identified what they believed were the elements necessary for capital market stability, efficiency and growth. They argued, among other things, for a process of international convergence on auditing standards similar to that happening between the IASB and US FASB on accounting standards, making use of the International

Standards on Auditing (ISAs) already developed with the oversight of the Public Interest Oversight Board of IFAC.

The conditions are right to see convergence on ISAs occur. The key stakeholders are moving towards convergence, with positive signs from the United States. The reasons are compelling: the ISAs are high quality standards; a common set of standards is in the interests of the capital markets and other users world-wide; and the resources devoted to standard setting can be more efficiently used. This movement can only be aided by decisions being taken by governments, regulators and others towards the adoption of greater consistency in regulatory and prudential frameworks around the world in the light of the global financial crisis.

It may take another 5 years or so to see convergence of auditing standards based on the ISAs, but I have no doubt it will occur.

The IAASB's clarity project

A necessary precondition for convergence was always going to be acceptance that the ISAs were high-quality auditing standards. In 2003, the IAASB decided to undertake a review of the drafting conventions used in its standards with the objective of identifying ways in which to improve the clarity, and thereby the consistency of application, of IAASB standards. This was a critical strategic decision by the Board, led strongly by its then Chair, John Kellas, from the United Kingdom.

In September 2004, an exposure draft *Clarifying Professional Requirements in International Standards Issued by the IAASB* was released. The exposure draft and accompanying consultation paper dealt with the IAASB's drafting conventions and some suggestions for resolving issues surrounding the structure, length and perceived complexity of the IAASB's standards. John Kellas remarked that these were "surprisingly controversial matters on which strong but differing views are held".¹⁵

The central elements of the IAASB's project to improving the ISAs through the clarity project included:

- objective-based standards;
- clarifying professional requirements;
- eliminating ambiguity arising from the use of the present tense; and
- improving reliability and understandability.¹⁶

Having settled on a set of drafting rules, the IAASB's initial intention was to redraft and revise all its standards by 2010-11. Feedback from constituents that the timeframe was too long resulted in a decision to revise only the more important standards, although all would be redrafted. The Clarity project was completed by the IAASB at the end of 2008, on schedule, and the Public Interest Oversight Board approved the due process for the last several clarified ISAs on 27 February 2009.

So what has been achieved?

The IAASB website notes that auditors worldwide will now have access to 36 newly updated and clarified ISAs and a clarified International Standard on Quality Control (ISQC), including

- One new ISA, addressing communication of deficiencies in internal control;
- 16 ISAs containing new and revised requirements (these are referred to as “revised and redrafted ISAs”); and
- 19 ISAs that have been redrafted only to apply the Clarity conventions and reflect matters of general clarity only (these are referred to as “redrafted ISAs”).¹⁷

The new, and revised and redrafted, ISAs include requirements and guidance that aim to strengthen practice in the following areas:

- Materiality in planning and performing an audit, and its use in evaluating misstatements;
- Risk assessment, and the gathering and evaluation of audit evidence, in relation to:
 - Accounting estimates (including fair value accounting estimates) and related disclosures;
 - Related party relationships and transactions; and
 - An entity’s use of a third party service organisation;
- Audit evidence considerations in relation to:
 - External confirmations; and
 - Written representations (including implications for engagement acceptance considerations);
- Using the work of others, in relation to:
 - Audits of group financial statements, including the work of component auditors;
 - Work of an auditor’s expert;
- Communication with those charged with governance;
- Communicating deficiencies in internal control;
- Auditor reporting, in relation to:
 - Modifications to the auditor’s opinion;
 - Emphasis of Matter paragraphs in the auditor’s report; and
- Audit and reporting considerations in the context of special engagements.

The number of changes reflected in the new body of standards is significant. My office has calculated that the 356 mandatory paragraphs in the current ASAs have become 547 in the new ISAs – an increase of 191 paragraphs. The UK Auditing Practices Board (UK APB) has also estimated that:

“Overall there is an increase of about a third in the number of requirements in the ISAs that apply to the performance of an audit of a single entity – about a half relates to ‘clarification’ of existing guidance and about a half of this increase relates to new requirements designed to improve audit quality. There is also an increase in the number of requirements that apply to group audits. This absolute increase in the

number of requirements in the ISAs does not however translate directly into changes in audit procedures to be performed and consequently future work effort as:

- some audit firms have taken the view that the current ISA guidance reflects the proper application of the existing standards, and have accordingly already incorporated it in their audit methodologies,
- some audit teams will already be undertaking procedures that correspond to the new requirements added as ‘improvements’ to the existing ISAs, and
- many of the additional requirements are conditional and will not apply to all audits, others relate to the contents of written communications such as auditor reports, letters of engagement and representation letters”.

Implementation

As you know, auditing and assurance standards in Australia are closely based on the standards made by the IAASB.

The AUASB, which was re-constituted as an independent statutory authority from 1 July 2004, is charged by the Financial Reporting Council (FRC) to develop Australian Auditing Standards that have a clear public interest focus and are of the highest quality, using as appropriate, International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as a base from which to develop the Australian Auditing Standards.¹⁸

The AUASB’s first application of ISAs as a base for Australian standards came, of course, with the release of the ‘force of law’ auditing standards to be applied under the Corporations Act.

Currently, the AUASB is releasing exposure drafts for its standards based on the ‘clarity’ version of the ISAs. The AUASB plans to complete this exposure draft process by late July, with the release of all approved standards, at the one time, by October 2009. The new standards will be operative in Australia for reporting periods beginning on or after 1 January 2010 (with systems of quality control required by the new quality control standard ASQC1, required to be established by 1 January 2010).

The IAASB has stressed that considerable effort will be needed to prepare for the introduction of the clarified standards.¹⁹

“The importance of successful implementation cannot be overstated, and the level of effort for successful implementation should not be underestimated.

While specific implementation considerations will vary by jurisdiction and depend on which ISAs are currently in force, there are some general considerations that may be relevant to all those responsible for successful implementation of the ISAs. These include: ...

[for] Accounting Firms and Audit Practitioners

- Review of firms’ system of quality control, audit methodologies, manuals and software;
- Development, or updating, of training programs; and
- Updating of audit programs and procedures.”

The IAASB is also providing implementation support – including a ‘clarity’ website²⁰ and support modules (IAASB staff are currently developing a series of ISA video modules and slides on a number of ISAs that have been recently revised and redrafted; they are proposed to be released this July).

The UK APB has estimated the possible impact on the cost of individual audit engagements of applying the clarity ISAs as follows:

	Audits of small and mid-sized entities	Audits of listed and large private companies
Sample size	14 companies / charities	13 companies
Average increase in recurring cost of the audit of an individual entity	9.6%	1.9%
Average impact of ISA 600 on group audits	0.5%	3.0%
Total recurring costs for group audits	10.1%	4.9%
Average increase in ‘year one’ non recurring costs	3.8%	0.1%
Total year one cost	13.9%	5.0%

Of particular interest, the UK APB assessed that

‘relatively little additional cost is expected to arise from the clarification of the existing ISAs. However, revision of some of the ISAs designed to increase audit quality has a more substantial impact’²¹.

Given the extent of the changes arising from the revised and redrafted standards, the IAASB has agreed, subject to any unforeseen circumstances, not to issue any additional standards that would become effective in the next two years. This responds to requests the IAASB has received from stakeholders for a period of stability in the standards as jurisdictions focus on the important task of implementing the clarified ISAs and ISQC 1.

The IAASB has also decided that it is important for it to take steps to ensure that its standards are being used properly. It is planning to explore how it might assess the effectiveness of the implementation of the new ISAs.

Regulation

It hasn’t only been the profession which has responded to changing world events. Legislatures in different countries have moved to strengthen statutory arrangements applying to auditing standards and auditors.

I referred earlier to the Sarbanes-Oxley Act in the US. In Australia, we also saw a move towards greater regulation of the accounting profession by government, given effect after much consultation and advice through the *Corporate Law Economic Reform Program (Audit*

Reform and Corporate Disclosure) Act 2004. This strengthened the Corporations Act with more demanding auditor independence provisions; standard setting moved away from the profession and became the province of Boards established by the Australian Government; and auditing standards were strengthened in line with giving them the 'force of law'. The significantly enhanced financial reporting requirements of the Act, including the enforcement of audit independence and audit quality requirements, continued to be subject to surveillance, investigation and enforcement by ASIC.

THE EXPANSION OF OPPORTUNITIES FOR ASSURANCE PROVIDERS

Overview: the assurance standards

Complementing the body of auditing and review standards for providing assurance over historical financial information is another, considerably smaller, body of standards for providing assurance over other areas of activity. There are three such standards in Australia. ASAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information* is the principal standard, with two 'adjunct' standards based on ASAE 3000, dealing with compliance engagements (ASAE 3100) and performance engagements (ASAE 3500). This latter standard is of particular relevance to my office, the Australian National Audit Office (ANAO), in the context of its performance audit program – a critical part of the public-sector audit mandate in view of the role of the Parliament in holding the Government to account.

A financial auditor venturing to look at these assurance standards for the first time will find themselves in recognisable territory – not surprisingly, since the assurance standards are based on the framework that embody the same tried and trusted elements underpinning the auditing standards. Briefly, these are:²²

- a three party relationship, involving an assurance practitioner, a responsible party and intended users (those for whom the assurance practitioner prepares the report);
- a subject matter that is capable of being evaluated and/or measured. Appropriate subject matter can range from, eg: an entity's non-financial KPIs, or its compliance with laws and regulations, to the effectiveness of its governance processes;
- suitable criteria which provide a yardstick or benchmark to allow consistent evaluation or measurement of the subject matter. Establishing criteria can present challenges, as the criteria must be relevant, complete, reliable, neutral and understandable;
- evidence, which must be sufficient (relating to quantity) and appropriate (relating to quality – its relevance and reliability); and
- finally, a written assurance report containing conclusions that reflect the level of assurance obtained: a positive form for a reasonable assurance engagement and a negative form for a limited assurance engagement.

This robust formula provides an opportunity for members of the profession with their particular skill set to move beyond financial auditing into other areas requiring assurance.

Assurance work of ANAO

As previously mentioned, the ANAO has a program of performance audits (some 45 – 50 per year) relating to the operation of government agencies and programs. These performance audits are conducted under the new assurance standard ASAE3500. Further to our performance audit and financial statement audit programs, the ANAO also undertakes other assurance activities utilising ASAE3000.

To illustrate the use of the assurance standard in better serving our client, the Parliament, the ANAO has recently instituted two on-going assurance review functions: reviews of Government information and advertising campaigns and a review of Defence Materiel Organisation major projects.

In June 2008 the Government released *Guidelines on Campaign Advertising by Australian Government Departments and Agencies*. The Guidelines stipulate that the Auditor-General must review Government information and advertising campaigns that cost more than \$250,000, or a responsible Minister may ask the Auditor-General to review a campaign of lesser value if the Minister consider a review is appropriate. We use these *Guidelines* as the criteria for our reports on government advertising campaigns. We released our first report – on the child care tax rebate campaign – in June 2008. Since then we have published some 27 such reports, covering a variety of campaigns, such as climate change, national security, binge drinking and the economic security strategy.²³

Following a recommendation from the Joint Committee of Public Accounts and Audit (JCPAA) in December 2006, we now also undertake a review of major Defence projects. In November 2008, we released the first report into DMO major projects, which reviewed selected information presented on 9 of DMO's top 30 projects covering project capability, budget, schedule and risks to project performance. We plan to report on 15 projects in 2009 and up to 30 projects in 2010. DMO's procurement budget is significant: in 2007-08 it spent almost \$4 billion on capital equipment projects, and the nine projects we reviewed had a total budget of \$13.535 billion at the end of the 2007-08 financial year.²⁴

In March this year, the JCPAA undertook separate public hearings into our assurance roles in reporting on government advertising and on DMO major projects; the Committee is yet to report on these inquiries.

Assurance on sustainability reporting

More broadly, in both the private and public sectors, there has been increasing emphasis on the behaviour of organisations; not simply on financial disclosure, but also on their social and environmental credentials and impacts. This has led to organisations reporting on these areas in addition to their financial information. Many companies now report on these issues in corporate sustainability reports, and in some cases these reports are assured by auditors.

According to Ballou *et al.*:

There are two major challenges in providing a sustainability report with auditor assurance: the suitability of the criteria management uses to prepare its sustainability report and the performance and reporting standards the auditor uses.²⁵

There is no one set sustainability reporting standard. Widely used are the *G3 Sustainability Reporting Guidelines*²⁶ issued by the Global Reporting Initiative (GRI) issued in 2006. One of the goals of the GRI for the issue of this version was to improve the relevance and auditability of the measures included in earlier versions. In 2007, the Swedish Government introduced a new requirement that all state-owned companies must submit sustainability reports using the GRI guidelines.²⁷

These guidelines define sustainability reporting as:

the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organisational development. 'Sustainability reporting' is a broad term

considered synonymous with others used to describe reporting on economic, environmental, and social impacts (e.g. triple bottom line, corporate responsibility reporting, etc.).

A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organisation – including both positive and negative contributions.²⁸

Such reports can be included in a company's annual report or as a standalone document, with the latter option most popular.²⁹

When using the reporting guidelines, the reporting organisation self-declares the level at which it applied the GRI guidelines (C, B or A), with each subsequent level requiring more components of the guidelines to be applied and more indicators to be reported. At each level, a '+' can be obtained (C+, B+, A+) if the organisation obtains external assurance on their report.³⁰

External assurance, as used by GRI, refers "to activities designed to result in published conclusions on the quality of the report and the information contained within it. This includes, but is not limited to, consideration of underlying processes for preparing this information". External assurance should assess the reasonableness and balance of the report; the extent of application of the GRI framework; be done by those competent in the subject matter area; and the results should be written and publicly available. The guidelines do not limit possible external assurance providers to professional auditors, as they refer to possible "stakeholder panels, and other external groups or individuals". Assurance providers may or may not be governed by an assurance standard. The guidelines emphasise the need for groups or individual's external to and independent of the organisation being examined.³¹ The GRI can also conduct a service to check that the reported level of compliance matches the guideline requirements. Where a '+' is reported, GRI will ensure the existence of assurance by an external party, but they will not review whether the external assurance has been conducted in accordance with the GRI guidelines mentioned above.³²

In Australia, 45 entities registered with the GRI website as having used the guidelines for reporting on sustainability between January 2008 and February 2009. The main sectors that provided this reporting were financial services; energy and water utilities; mining companies; and public agencies (for example the Gold Coast City Council). Of those, only five had obtained third party assurance; 17 were self-declared; 10 were checked by the GRI that their reporting met the requirements of the guidelines; and 16 did not declare whether they had been assessed.³³

As with the reporting standards, there is no agreed global standard for providing assurance on sustainability reports. ISAE 3000 on Assurance Engagements has been used in some cases. Also commonly used is a standard developed by the organisation AccountAbility for use with sustainability performance and reporting, AA1000. (AccountAbility is an international think tank established in 1995 with the aim to promote accountability in the area of sustainable development).

It was reported elsewhere that the AA1000 Accountability Standard, while a much improved tool and a positive step, "lacks the broader audit framework that is provided by International Audit and Assurance Standards Board standards.... Although AA1000AS is intended for use by all assurance providers, in reality it is likely to be used in full by assurance providers outside the accounting profession". The article acknowledged that a standardised approach by assurance providers to assurance on sustainability reporting was some time away.³⁴ These developments present opportunities for accountants in co-ordinating the preparation of sustainability reports and for auditors to provide assurance in relation to them, utilising experts as appropriate. Ballou noted in this regard that if accountants fail to act on the

opportunity, companies may adopt other perhaps less rigorous means of obtaining assurance.³⁵ It is interesting to note, in this context, that Ballou was implicitly acknowledging the strength of the auditing profession's assurance framework.

Assurance on carbon trading schemes

Another potential area of new business for the profession is in relation to assurance on reports relating to carbon emissions and carbon trading schemes. Carbon emissions trading schemes are being implemented in a number of countries because of a recognition that the increasing amount of greenhouse gases in the atmosphere poses potentially significant long term harm to the planet. Many reports have demonstrated the danger posed by increasing greenhouse gas emissions and the need for trading schemes, for example, the UN Intergovernmental Panel on Climate Change (IPCC report), the UK Stern report and, in Australia, the Garnaut report.

The main approach to emissions trading is a 'cap and trade' system, which is proposed for introduction in Australia at the national level. Such a scheme places a cap on the total amount of emissions to be produced per year. Affected businesses can acquire credits (termed units under the Australian ETS) through government allocations or auctions. Entities that cannot decrease their emissions may purchase credits from others who improve their environmental performance by decreasing their emissions. Incentives are provided to reduce emissions (allowing businesses to sell units to other liable businesses), while fines may be incurred by those who go over their allowance.³⁶

An obvious key issue that would underpin the integrity of a cap and trade system is the measurement of emissions. This includes both how to measure and ensuring the measurement is accurate (or as accurate as can be expected given technology/ techniques available).

Writing for the IAASB, Michael Nugent states: "Quantification of an entity's emissions inventory...is the backbone of all ETSSs," and should contain data suitable for an assurance engagement.³⁷ The role of audit in such a scheme is critical to its operation: namely to provide assurance on an entity's statement of emissions.

Having the auditing profession undertake such work would give other stakeholders assurance over the published figures. According to the external audit consultation paper for the proposed Australian trading scheme:

External auditor independence is a complex and wide-ranging issue. An independent external auditor constitutes the principal external check on the integrity of reports submitted by registered entities under the NGER Act and the Carbon Pollution Reduction Scheme.³⁸

The IAASB has decided to develop a standard for providing assurance over carbon emissions, with a first draft to its next meeting in June 2009. A final standard is scheduled for the 2nd quarter of 2011.³⁹ The issues the IAASB expects to consider in formulating a standard include:

- The suitability of criteria set by a regulator for other users;
- Using the work of an expert – verifying emissions reporting may be beyond the capacity of the audit professional alone: specialists such as engineers may be needed to validate measurement techniques and reported outcomes. Nevertheless, the assurance practitioner needs sufficient involvement and understanding of the work to provide assurance;
- The level of assurance to be provided – the standard will cover both reasonable and limited assurance, given that “It is questionable whether limited assurance is an adequate public policy response”.⁴⁰ The Board also cautioned that an unmodified limited assurance report is not an appropriate response where the subject matter might be regarded as ‘soft’ or where systems are immature, any more than an unmodified reasonable assurance report;
- Evidence gathering procedures;
- Materiality – whether the concept works in this area. For example, should it extend to evaluating environmental impact, and the relationship between materiality and precision, given the potential for a high degree of uncertainty in emissions measurement;
- Form and content of the assurance report, including requiring disclosure of the training and qualifications of those performing the engagement and perhaps a statement of compliance with professional codes and standards.

The Institute of Chartered Accountants argued for assurance requirements to underpin reporting in Australia from the beginning, and stated that “Australia’s auditing framework is scalable and readily adaptable to all types of data and enterprises”. The Institute emphasised the need to develop global reporting criteria to ensure consistency across jurisdictions.⁴¹ CPA Australia has emphasised the need for quick action to have auditing and accounting standards implemented. It has recommended to both the AUASB and the AASB to focus on these issues, as they are central to a trading scheme.

In passing, I mention that the International Accounting Standards Board and the US Financial Accounting Standards Board are jointly addressing the accounting issues associated with emissions trading. The project was activated in December 2007 in response to increasing international use of ETs and considerable diversity in treatment that was becoming apparent.

Australian greenhouse gas and energy reporting

The Australian system for greenhouse gas reporting and emissions trading is one that is constantly evolving. The *National Greenhouse and Energy Reporting Act 2007* (the NGER Act) – which received royal assent in September 2007 – establishes the legislative framework for a National Greenhouse and Energy Reporting System. This will form the basis of Australia’s Emissions Trading Scheme: the Carbon Pollution Reduction Scheme, which the government has committed to introducing in 2010. The reporting system covers the reporting, from July 2008, of “emissions, reductions, removal and offsets, and energy consumption and production”.⁴² On 10 March, the government released an exposure draft of the *Carbon Pollution Reduction Scheme Bill 2009*, which states that the Carbon Pollution Reduction Scheme will apply to “facilities that emit greenhouse gases of 25,000 tonnes of

carbon dioxide equivalence or more per year and to entities that supply certain fuels and synthetic greenhouse gases".⁴³

The NGER Act and proposed amendments do not specify the type of external audit that must be carried out under the scheme. It requires that auditors must register with the Greenhouse and Energy Data Officer. Under the proposed amendments, to be eligible to register, auditors must meet requirements as to qualification, knowledge, expertise, competence, independence and other matters.

The Officer has the power to have a registered auditor conduct an audit of an entity's adherence to the NGER Act. The notice the Officer provides to the organisation about such an audit will specify the issues to be covered by the audit report.⁴⁴ While the Act provides for the Greenhouse and Energy Data Officer to determine guidelines external auditors must follow when preparing audits, no guidelines have as yet been developed, although consultation with the audit profession has occurred following the release of the external audit consultation paper.

According to the external audit consultation paper, the Government favours the external auditing of emissions reports, submitted under the Scheme, to accord with the NGER Act and standards from the Australian Auditing and Assurance Standards Board. The paper notes that most external audits of emissions information would be conducted by teams with industry specific and technical skills because of the nature of measuring and monitoring emissions. However, a 'lead' auditor "would need to understand an experts' work, and be able to credibly accept responsibility for expressing an assurance opinion".⁴⁵

The paper identifies ASAE 3000 as providing "useful guidance on the basic elements to be included in an audit report" and proposes that this standard form the basis of the external audit guidelines legislative instrument. An ISO standard, ISO 14064-3:2006 *Greenhouse gases -- Part 3: Specification with guidance for the validation and verification of greenhouse gas assertions*, would also be used as a basis for developing parts of the audit instrument. As for the level of assurance to be required, the paper states that the assurance provided by compliance external audits "will differ on a case by case basis".⁴⁶

The AUASB has been providing submissions and on-going advice to the Department of Climate Change (DCC) on the various aspects of the development of the assurance requirements for NGER reporting. In particular, the AUASB has advised the DCC on:

- The key audit requirements to be included in the External Audit Legislative Instrument, which will set out the mandatory requirements for the conduct of an audit under the NGER Act;
- The criteria for registration of auditors under NGER Regulations;
- Amendments to the NGER Act to reflect the refinement of the audit requirements; and
- The Assurance requirements for data submitted for assessment of activities as Emissions Intensive Trade Exposed, in order to be eligible for assistance under the EITE scheme.

The AUASB's input is on-going in these areas. In addition, further work with the DCC is anticipated with respect to the development of Audit Guidelines, to provide guidance on the application of requirements in the Legislative Instrument, and in advising on the assurance requirements with respect to applications for EITE assistance.

eXtensible Business Reporting Language (XBRL)

Another area where the profession has maintained a watching brief for some time is the use of XBRL for business purposes and for the filing of business returns.

You may be aware that in December 2008, the US Securities and Exchange Commission (SEC) ⁴⁷ voted to require public companies and mutual funds to use interactive data for the provision of financial information. The first public companies to be required to provide interactive data reports (those with a world wide public float over \$5 billion) will start with their first quarterly report for June 15, 2009. By December 2011, all U.S. public companies (whether using US GAAP or IFRS) will have filed interactive financial information for use by investors. Mutual funds will file interactive data from 2011. The standard for reporting interactive data is XBRL.

The SEC described the benefits in the following terms:⁴⁸

“Today, because the information in SEC filings starts out in life imprisoned within a form, most of it is routinely re-keyboarded and parsed by private companies and service providers so that it can be digested by computers, and from there put to good analytical use.

“By improving the methods companies use to disclose information to their shareholders and to the public, we can make that information easier for investors to get, easier for investors to use, and more efficient and more cost-effective for companies to disclose.

“And, thanks to the quality control advantages made possible by technology, we expect accuracy and precision to improve as well.”⁴⁹

In Australia, Standard Business Reporting (SBR) to the Federal Government is scheduled for introduction in mid-2010. SBR is XBRL based and will streamline the provision of financial information to the many government agencies (State and Federal) that receive it, and cut a claimed \$800 million in business red tape:

“Forms included in the project include business activity statements, pay-as-you-go tax returns, financial statements lodged with the Australian Securities and Investment Commission and payroll tax reports.”⁵⁰

Unlike in the US, the take up is voluntary and the Australian project is focussed on delivering information to government and not beyond.

How will the new technology affect the assurance over that information? The CEOs of the six international audit networks suggest that

“In a world of “mass customisation”, standard financial statements have less and less meaning and relevance. The future of auditing in such an environment lies in the need to verify that the *process* by which company-specific information is collected, sorted and reported is reliable and the information presented is relevant for decision-making”.⁵¹

As highlighted by Dr Hans Verkruijsse of The Netherlands, an international specialist in audit issues relating to XBRL:

'the auditor . . . will have to enter virtual space with his audit approach so that he can quickly provide the management's statement regarding the reliability of the data with the necessary assurance. The only way the independent auditor can achieve this is by implementing the continuous auditing concept. In his audit approach, the independent auditor can rely on the continuous monitoring process as he did on the internal control process in the pre-tagged data era. Within the contours of the virtual space, and in an appropriate manner, the details must be decided upon for the requirements and needs of the users of the organisation's data, the management's reliability statement and the assurance provided for it by the independent auditor.'⁵²

Dr Verkruijsse has indicated that in this world:

- The independent auditor would like to rely as much as possible on the internal control structure of the organisation;
- As part of the audit approach, the independent auditor will have to enter the virtual space in order to find sufficient audit evidence to provide a sound basis for his assurance by default statement;
- where in the pre-tagged era, the audit opinion reflects a true and fair 'view' of information provided through a responsibility statement, there is no 'view' anymore – the stakeholder who has received the underlying data will construct the 'view' by himself;
- The materiality concept as we know it does not exist in this world;
- The focus of the auditor will be on the effectiveness of the continuous monitoring process by concentrating on the general controls, the meta data and meta process controls.⁵³

In the light of the growing interest in audit issues relating to XBRL, the IAASB has flagged in its strategic directions an intention to develop, in consultation with national standard setters and relevant XBRL groups, guidance for auditors on the approach to be followed when XBRL financial statements are to be filed together with the auditor's report (XBRL). It will also monitor developments in continuous auditing and the continuous availability of information to assess the areas in which to develop guidance.⁵⁴

The core business for the profession has been, and continues to be, the audit of financial statements. However the demand for assurance in new areas of reporting that are seen by business or government as critical performance information will continue to provide new opportunities for auditors to add credibility to presented information.

CHALLENGES FOR THE PROFESSION AND THE FIRM

Challenges for the auditing profession

As for business, the influences for the profession going forward will be both global and local, and create challenges that need to be managed at both the profession and firm levels.

The most significant global issue currently is the global financial crisis.

It is probably fair to say that the public spotlight in the current financial crisis has not focussed much to date on the role of the auditor. No doubt, we will hear some more about

this in the months and years ahead, as more in depth analysis of the corporate failures, and losses takes place.

Nevertheless, there has been some informed comment on the challenges the auditor will face as a result of this crisis.

Rene Ricol, a former IFAC President, was commissioned by the President of the French Republic, in the context of the 2008 French Presidency of the EU, to prepare a report on the financial crisis. His report, delivered in September 2008,⁵⁵ made a number of key points. On the subject of “Statutory audit and statutory auditors”, it harked back to the financial crisis in 2001 and the series of “spectacular” reforms undertaken by the profession in conjunction with the Financial Stability Forum⁵⁶ and market regulators and the four main thrusts of those reforms:

- shared or outside regulation;
- oversight of the public-interest activities of IFAC, particularly in the areas of audit standard-setting and ethics;
- an extremely stringent standard for internal control at audit firms, including a systematic concurring partner procedure before an opinion is issued; and
- stricter limits on the work done for audit clients.

The Report then noted that, although auditors have not attracted criticism over the subprime crisis, there were continuing challenges related to the auditing profession. Apart from recommending that Europe converge to ISAs and the IFAC independence standard, two key challenges were noted.

- “Auditors may see their role evolving, as they report more fully on future risks faced by audited companies. However, auditors are reluctant to report publicly more fully on risk identification because of liability issues, which need to be solved. This situation may create a serious gap between the information on past events given in the audit report and expectations by the industry for a forward-looking opinion on risks facing companies.
- “National supervisors and inspectors, within and outside Europe, need to develop mechanisms to cooperate more effectively at operational level in the external control of audit firms”.

The current President of IFAC, Robert Bunting, took up his position in November 2008. In his first address to the IFAC Council, he spoke about the global financial crisis in these terms:

“Today is a time of global uncertainty, and economic instability. Recession seems to be a certainty in most of the developed economies. The question is not “if” but “how severe and how prolonged.”

“Questions are being raised about how to control the damage in this economic cycle and how to prevent similar problems in the future. Governments, regulators, standards setters, market makers, financial institutions, rating agencies, and service providers to name but a few, are being forced to defend their role in the financial meltdown and offer changes to prevent any reoccurrence of the current problems.

“The accounting and auditing profession and their regulators and standard setters have been and will continue to be called upon to explain how the crisis came about, what could have been done to prevent it and what, if any, changes must occur to

prevent future problems. We must not wait to be called upon, we must be pro-active, we must be part of the process of finding and implementing solutions.

“EU Commission President Jose Manuel Barroso said that in order to restore stability in the markets, we must not only “inject liquidity,” we must also “inject credibility.” It is in this latter area where our profession can play a role.

“And so my first area of emphasis as IFAC President is to undertake initiatives to help combat the fear, frustration, and overall lack of confidence in the markets. This is not something we can do alone; it is an area in which we can and should be among the leaders in finding solutions and advocating appropriate and considered actions.

The rapid expansion of the credit crisis from the US to Europe to Asia and the rest of the world has demonstrated conclusively just how integrated the world’s financial structures are. This, I believe, demonstrates the relevance and importance of our strategic themes and fortifies our arguments for one set of global standards for auditing, ethics, education and financial reporting.”⁵⁷

To assist practitioners in addressing some of the consequences of the global financial crisis, IFAC has released two staff practice alerts. The first was released in October 2008 on [Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment](#). It was developed following consultation with the IAASB's Task Force on Fair Value Auditing Guidance, which is considering the need for new or modified guidance in light of current marketplace issues. The purpose of the alert is to highlight areas within the International Standards on Auditing (ISAs) that are particularly relevant in the audit of fair value accounting estimates in times of market uncertainty. The alert directs auditors to the recently revised ISA 540 (Revised and Redrafted), [Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures](#), which was influenced by the changes in the credit markets during 2007. While not effective until audits of financial periods commencing on or after December 15, 2009, it includes guidance that is likely to be useful to auditors planning their current engagements.

A second Audit Practice Alert [Audit Considerations in Respect of Going Concern in the Current Economic Environment](#) (January 2009), deals with the effect of the credit crisis and economic downturn on an entity's ability to continue as a going concern and whether these effects ought to be described in the financial statements. It also raises awareness of issues surrounding liquidity and credit risk that may create new uncertainties for entities or exacerbate those already existing.

In considering the global financial crisis in his Ken Spencer Memorial address, the Chair of the PCAOB, Mark Olson noted:

“The decline has raised questions about management judgment, the adequacy of risk management models, and potential holes in our regulatory framework. Moreover, the current crisis has unveiled a startling, although perhaps not entirely surprising, growing number of significant financial frauds, some of which have a global reach.”

“In financial institutions, which have been -- in many ways -- the centre of the current crisis, there continues to be concern about whether all the losses have been recognized and that many may not have enough capital to sustain their current and future losses”.

“In light of these developments, government leaders, regulators, market participants and auditors are focusing, not simply on the crisis at hand, but on the need for

thoughtful, long-term solutions. Regulators worldwide are working with their governments to design solutions to address weaknesses in their respective financial sectors – and I hope that we can all reach across our borders to learn from each other and collaborate on viable solutions.”

“In addition to these national issues, our globalized markets require a better framework that aligns supervisory objectives, and enhances collaboration and cooperation among financial supervisors globally. More should be done to support cross-border supervisory coordination. This is no time for us to slip back into our own national trenches.”

This scenario is also true for auditor oversight, and audit oversight bodies must adjust and respond to the current environment. To this end, the PCAOB continues to monitor developments and adjust its programs accordingly, while communicating with ... fellow regulators and standard-setters, the audit firms ..., public companies, and investors. At year-end 2008, for example, in response to a number of serious and mounting risks surfacing in the audit environment, the PCAOB staff issued an Audit Practice Alert to focus auditors’ attention on areas of heightened audit risk where they should pay particular attention and take appropriate measures to address.⁵⁸ These areas included – not surprisingly -- fair value measurement, impairment-related challenges, and going concern determinations, among others.⁵⁹

ASIC’s focus on oversight is along the same lines. The ASIC Chair recently indicated that the priority for ASIC’s accountants and audit group is to focus on audit quality and on the new accounting issues (e.g. fair value) which are emerging from the current crisis.⁶⁰ ASIC’s then Chief Accountant had foreshadowed the accounting focus previously in July 2008 - valuation accounting, the correct treatment of off balance sheet entities and the correct classification of debt as current or long term.

Apart from the immediate challenges in auditing arising from the global financial crisis and individual audits, there is the evergreen issue of the expectation gap that the profession has to deal with. The profession has sought to improve the quality of audit reports by more clearly articulating the scope of an audit and the responsibilities of management and those charged with governance on the one hand, and those of the auditor on the other.

There have also been suggestions made by the Group of 6 CEOs of the big international audit networks in November 2006 to “confront the expectation gap regarding fraud detection”. They proposed that public companies should be subject to a forensic audit, perhaps on a regular 3 to 5 year basis , or maybe randomly, or else letting governing bodies choose the level of fraud detection intensity.

This proposal has made it to the Standing Advisory Committee of the PCAOB. A background paper prepared for the SAC noted that ISA 240 on Fraud (2004) had “forensic type procedures” (similar to the PCAOB standard) for instance the discussion among team members re susceptibility to misstatement from fraud, making enquiries of management, those charged with governance and others about their knowledge of fraud, and the procedures required to respond to the risk of management override of controls.

According to one commentator, the reaction from the Committee was ‘tepid’ partly due to the nature of forensic audits (“Fraud, by definition, is tough for an outsider to detect because at its heart it's about concealment by a person or persons who have an insider's advantage”), but a less stringent option may yet have a future.⁶¹

More broadly, the Advisory Committee on the Auditing Profession to the US Treasury Department has recommended that:

“the PCAOB undertakes standard setting initiatives to consider improving the content of the auditor’s report beyond its current pass/fail model and to require an engagement partner sign the auditor’s report.”⁶²

*IAASB Strategy 2009-11*⁶³

One focus of the IAASB’s medium term strategy for 2009-11 is the continuing development of standards. I have already mentioned the work the IAASB is planning to do on emissions trading and XBRL. In addition, there will be an emphasis on standards that contribute to the effective operation of the world’s capital markets and those relevant to small and medium sized entities and practices (SMEs and SMPs).

In particular, the IAASB is planning:

- to develop standards relevant to professional accountants reports in prospectuses and possibly revisions to the review and compilation standards to assist auditors of SMEs;
- to revise a number of its standards (including aspects of the audit report standards that have become a barrier to adoption); and
- to determine whether to develop further certain key concepts e.g. Materiality, audit evidence and professional judgement.

The IAASB is firmly of the view that ‘an audit is an audit’ and that ISAs are standards to be applied to all audits, including those of SMEs. Nevertheless, the IAASB is conscious of the difficulties sometimes faced in implementing ISAs in this field and the thinking in some jurisdictions that a review or some other form of engagement, rather than an audit, may be the more appropriate service for some SMEs. With this in mind, the IAASB has established a task force to look at the standards for review engagements (ISRE 2400) and compilations (ISRS4410). That task force will also consider the work of a number of national institutes, in particular those in the US, Germany and the UK, who have been exploring whether an alternative type of engagement might be appropriate.

Challenges for the firm

Moving from the challenges facing the profession to the challenges for the firm, the greatest ongoing challenge for the audit firm remains maintaining audit quality in the face of more conceptually sound but complex standards, and increasing business complexity. Audit quality is the driving concern for regulators, standard setters and practitioners the world over. And the first driver that gets mentioned is the tone-at-the-top.

In October 1998 a ‘Panel on Audit Effectiveness’ was established in the US in response to a request by the Securities and Exchange Commission. The Panel conducted a comprehensive review and evaluation of the way independent audits of financial statements of publicly traded companies are performed and assessed the effects of recent trends in auditing on the quality of audits and on the public interest.

In its 2000 report⁶⁴, the Panel made recommendations on (i) improving the conduct of audits (including in relation to earnings management and fraud), (ii) auditor independence (iii) the governance of the profession in the US and (iv) the audit firm as an organisation protecting

the interests of the investing public. We have seen developments internationally in all of the first three areas mentioned, following the company collapses in the early part of this decade.

In relation to the audit firm itself, the Panel recommended action in four areas. These recommendations concerned:

- Professional leadership – the tone at the top
- Professional development
- Personnel Management and
- Time pressures on auditors.

Concerning professional leadership and the tone at the top, the Panel noted that:

“The “tone at the top” of an audit firm is a major influence on its culture. It determines, for example, whether the culture is quality-oriented or sales-oriented, and whether top management extols the important role audits play in the capital markets or acts as if audits are little more than minimum value commodities.

“Audit personnel constantly receive messages from firm management on such topics as audit efficiency and effectiveness, client service, client relationships, profitability, marketing of services and development of personnel. Often these messages only indirectly imply that quality audit work is an integral part of quality client service. They often do not focus directly on audit quality in the context of a service provided to protect the interests of the investing public.”

The Panel therefore called on audit firms to “reaffirm, within their organisations and to the outside world, the importance of their audit practices and to stimulate their auditors to proudly hold high the banner of objectivity, independence, professional scepticism and accountability to the public by performing quality audit work.”⁶⁵

In December 2007, the Forum of Firms acknowledged the importance of tone at the top in contributing to audit quality and that audit quality must be a priority for every audit firm. The Forum stated that

“If audit quality is to remain a real priority, audit firms must create and sustain a culture of positive and constant reinforcement. Importantly, this can be supported by the tone set by firm management through the policies and procedures they put in place, their communications on their expectations with respect to compliance, the system of reward and sanctions they implement and, of course, the example they set through their own behaviour.”

The Forum’s paper, *Tone at the Top and Audit Quality*, summarised current practice in several of the largest international audit firms and examined how setting the right tone can positively influence audit quality. It also summarises its principal findings, which relate to strategy, communications, job descriptions, performance appraisal and monitoring.

As indicated previously, the Chairman of the PCAOB, Mark W Olson, delivered the 2009 Ken Spencer Memorial Lecture.⁶⁶ He addressed a number of matters affecting audit firms. In one place, he described the PCAOB’s inspection program and noted that the assessment of a firm’s quality control systems involved evaluation of “certain key processes in addition to assessing the firm’s technical proficiency, such as client selection, compensation packages, leverage, internal inspections and the overall management approach, including the firm’s tone-at-the-top”.

After noting that for the largest firms, these processes are evaluated in a more sophisticated way, including establishing higher expectations for how these firms monitor and manage quality, he offered the following:

"I can distil those expectations down to one key message: it is essential that audit firms take on the responsibility to establish a culture of quality, to provide sufficient training, support and resources to execute audits; and, importantly, to establish strong monitoring processes to ensure that quality deficiencies are understood and remediated.

I can even take this one step further: firms should evaluate, both individually and collectively, the results of positive and negative indications of audit quality ...and where quality is not what the firm expects – and this could be something less than audit failure – the firm should make a judgement as to the root cause ... and determine if there are systematic implications to be addressed. "

The UK Financial Reporting Council released in February 2008 a document called *The Audit Quality Framework*.⁶⁷ The discussion paper that preceded this document noted that the high profile company collapses early this decade had subjected the quality of financial reporting and the effectiveness of the audit process to unprecedented analysis, review and reform.

The document identified the key drivers of audit quality as:

- The culture within an audit firm;
- The skills and personal qualities of audit partners and staff;
- The effectiveness of the audit process;
- The reliability and usefulness of audit reporting; and
- Factors outside the control of auditors affecting audit quality.

As to culture, the UK FRC stated that the culture of an audit firm is likely to provide a positive contribution to audit quality where the leadership of an audit firm:

- Creates an environment where achieving high quality is valued, invested in and rewarded.
- Emphasises the importance of 'doing the right thing' in the public interest and the effect of doing so on the reputation of both the firm and individual auditors.
- Ensures partners and staff have sufficient time and resources to deal with difficult issues as they arise.
- Ensures financial considerations do not drive actions and decisions having a negative effect on audit quality.
- Promotes the merits of consultation on difficult issues and supporting partners in the exercise of their personal judgement.
- Ensures robust systems for client acceptance and continuation.
- Fosters appraisal and reward systems for partners and staff that promote the personal characteristics essential to quality auditing.
- Ensures audit quality is monitored within firms and across international networks and appropriate consequential action is taken.

Most recently, in mid April, the AUASB released exposure drafts for proposed quality control standards ASQC1 *Quality Control for Firms that Perform Audits and Reviews of Financial Report, Other Financial Information and Other Assurance Engagements* and ASA 220 *Quality Control for Audits of a Financial Report and Other Historical Information*. AUASB Chairman, Merran Kelsall emphasised the importance of firms and audit practitioners

assuming responsibilities to establish a robust system of quality control at both the firm and engagement levels, in the following terms:

“It is important that the entire leadership team within a firm sets the right tone and serves as an example to others in terms of the importance they attach to quality of audit and assurance practices and ensuring that the firm's policies are followed when conducting auditing and assurance engagements.

“ASQC 1 ensures that the structures in place within the firm do not allow commercial pressures to compromise audit quality”.

As you are aware, the Institute undertakes quality reviews of its members' practices. I have reviewed the Institute's Summary of Issues arising from quality reviews from 1 July 2008 to December 2008, covering reporting year-ends of June 2007 and since, when the first suite of auditing standards made by the AUASB (the force of law standards) came into effect. Some 242 reviews were undertaken, largely of either sole practitioners (60%) or practices with 2 to 4 practitioners (33%).

The Institute wrote to members, noting the critical importance of files containing sufficient audit evidence, and of work being documented thoroughly, as per the current Australian standards. The Institute also drew attention to the tools it provides to assist members, including a Guide on Quality Control.

The documentation requirements are rigorous because the work we do as auditors requires us to make judgements about many matters that are significant to the outcome of the audit, and those judgements need to be able to withstand scrutiny. The new clarity standard on documentation provides useful additional guidance.

CONCLUSION

In today's increasingly complex and interconnected world, there is no place for complacency for any professional group. In recognition of this, the auditing profession has invested heavily in measures that will stand it in good stead going forward, including:

- strengthening IFAC, the global professional body, and international co-ordination;
- reinforcing standards on independence which are at the core of our profession;
- rewriting the full body of auditing standards to enhance audit quality; and
- gaining support for global convergence to the ISAs.

The auditing profession has shown itself to be adaptable, moving from a position of self-regulation to a largely regulated model in many countries. In the light of the global financial crisis, we can expect global regulators and audit oversight bodies to be focused on exploring avenues to adopt some uniform regulatory regimes.

The auditing profession has also extended its body of auditing standards to cover the provision of assurance on a wide range of subject matters. I see this as a growth area for the profession as legislators and shareholders appreciate the benefit of auditors adding credibility to critical information being reported through independent assurance activity.

As a profession, we also need to do more to address the expectation gap through further work on the audit reporting standards and our communication with key stakeholders.

Of course, the effective performance of auditing and other assurance engagements relies on practitioners. This is where the rubber meets the road, necessitating an ongoing investment in methodologies and professional development. There are cost implications here, as illustrated by the work of the UK Auditing Practices Board. Further, we need to ensure that any issues arising from quality assurance reviews within the profession are taken into account in our approach going forward.

No doubt there will be some experiences arising from corporate failures and losses as a result of the global financial crisis that will need to be factored into practice, and possibly the body of auditing standards – in this context it is noteworthy that IFAC has, in the last six months, released practice alerts concerning auditing fair value accounting estimates, and audit considerations in respect of going concern.

The forward work programs of the IAASB and AUASB will also influence practice for all firms – large, medium and small.

Looking to the future, I take comfort from the investment by the profession in organisational and standard setting arrangements to guide the profession in a strategic way. At the individual engagement level, each of us needs to invest sufficiently to ensure that our work satisfies the requirements of the profession's standards, which are acknowledged to be of a high quality.

The auditing role is important to the effective functioning of the financial markets. It has evolved over centuries, and will continue to do so, in the public interest.

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- ¹ *The Ascent of Money: A Financial History of the world*, Niall Ferguson, p4.
- ² Ferguson, p4.
- ³ *OECD Economic Outlook - An Interim Report*, Paris, 31st March 2009, Klaus Schmidt-Hebbel, Chief Economist and Head of Economics Department.
- ⁴ The Department of the Treasury Advisory Committee on the Auditing Profession, Final Report October 6, 2008
- ⁵ "The Future of Auditing", Anonymous, *The Accountant*, Volume 106, January 17, 1942, p.31
- ⁶ "The Philosophy of Auditing", Mautz, RK and Sharaf Hussein A, p.5 Publisher: American Accounting Association Date Published: 1964 ISBN-13: 9780865390027 ISBN: 0865390029
- ⁷ Ivey Business Journal, November/December 2004, quoting from *The Smartest Guys in the Room* by Bethany McLean and Peter Elkind (Portfolio, 2003).
- ⁸ International Auditing and Assurance Standards Board: A Brief History of its Development and Progress at http://web.ifac.org/download/IAASB_Brief_History.pdf July 2007.
- ⁹ International Auditing and Assurance Standards Board Terms of Reference – March 2006
- ¹⁰ The "Guide to Using International Standards on Auditing in the Audit of Small- and Medium-sized Entities" is available free of charge at <http://www.ifac.org/Store/Details.tmp?SID=1197644225547443&Cart=12407881201519112> and "The Australian Auditing Manual" is available free of charge to ICAA members at http://charteredaccountants.com.au/promotional_events/ProductId=A121603920
- ¹¹ Directive 2006/43/EC of the European Parliament and of The Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/ 660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.
- ¹² *Report to the President of the French Republic on the Financial Crisis*, September 2008, at <http://www.ifac.org/financial-crisis/>
- ¹³ PCAOB member Bill Gradison has noted the major change underway in the US that international financial reporting standards for the first time can be used by foreign private issuers without reconciliation to GAAP and also the possibility that the SEC may extend the use of IFRS to domestic issuers. These moves call attention to the variation in auditing standards both globally and within the United States. Written Remarks by Bill Gradison, Founding Board Member, Public Company Accounting Oversight Board, Colorado Society of CPAs, Denver, CO, December 19, 2008
- ¹⁴ PCAOB Release No 2008-006 October 21, 2008
- ¹⁵ Report of the IAASB Chairman, John Kellas, 2004 IAASB Annual Report.
- ¹⁶ IAASB Annual Report 2005, pages 9 and 10.
- ¹⁷ IAASB Clarity project update, October 2008 at http://web.ifac.org/download/IAASB_Clarify_10_08.pdf
- ¹⁸ The FRC's Strategic Direction to the AUASB issued on 6 April 2005, from AUASB Corporate Plan 1 July 2006 to 30 June 2007.
- ¹⁹ IAASB Clarity Project Update October 2008.
- ²⁰ <http://web.ifac.org/clarity-center/index>
- ²¹ UKAPB Consultation Paper, p9
- ²² Australian Auditing and Assurance Standards Board (2007) *Framework for Assurance Engagements*, see pp. 15-30.
- ²³ For more information see http://www.anao.gov.au/director/publications/AG_Assurance/Government_Information_and_Advertising_Campaigns.cfm
- ²⁴ ANAO Report No.9 2008-09 *Defence Materiel Organisation Major Projects Report 2007-08*, pp.14-15.
- ²⁵ Ballou *et al.* (2006) "The Future of Corporate Sustainability Reporting: A rapidly growing assurance opportunity", *Journal of Accountancy*, December.
- ²⁶ The GRI is an organisation made up of a wide variety of different stakeholders supported by a small core secretariat. The GRI website reports that over 1 500 companies have adopted the reporting guidelines, while in 2008 over 900 countries

reported their compliance with the *Guidelines* on the GRI website. See http://www.globalreporting.org/NR/rdonlyres/E033E311-68E7-41F9-A97F-9F3B94F3FE40/2546/2009GRIList_Mar17.xls

²⁷ Minister of Enterprise, Energy and Communications (2007) "Clearer requirements for information about sustainability for state-owned companies", <http://www.sweden.gov.se/sb/d/8194/a/93506>; "Guidelines for external reporting by state-owned companies", <http://www.sweden.gov.se/content/1/c6/09/35/06/453ac39d.pdf>.

²⁸ Global Reporting Initiative (2006) *Sustainability Reporting Guidelines*, p. 3.

²⁹ Garg, L.K. "Assurance on Sustainability Reporting", http://www.ica.org/post.html?post_id=2929, accessed 11 February 2009.

³⁰ *GRI Application Levels*, <http://www.globalreporting.org/NR/rdonlyres/FB8CB16A-789B-454A-BA52-993C9B755704/0/ApplicationLevels.pdf>.

³¹ Global Reporting Initiative (2006) *Sustainability Reporting Guidelines*, p. 38.

³² *GRI Application Levels*, <http://www.globalreporting.org/NR/rdonlyres/FB8CB16A-789B-454A-BA52-993C9B755704/0/ApplicationLevels.pdf>.

³³ See http://www.globalreporting.org/NR/rdonlyres/E033E311-68E7-41F9-A97F-9F3B94F3FE40/2546/2009GRIList_Mar17.xls.

³⁴ Anonymous (2008) "A new and improved tool", *Accountant*, Iss. 6060, November, p. 11.

³⁵ Ballou *et al.* (2006) "The Future of Corporate Sustainability Reporting: A rapidly growing assurance opportunity", *Journal of Accountancy*, December.

³⁶ See Nugent, Michael (2008) *Issues Paper – Emissions Assurance*, International Auditing and Accounting Standards Board, <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4372>, p. 3.

³⁷ Nugent, Michael (2008) *Issues Paper – Emissions Assurance*, International Auditing and Accounting Standards Board, <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4372>, p. 4.

³⁸ Department of Climate Change (2008) *National Greenhouse and Energy Reporting Act 2007 and Carbon Pollution Reduction Scheme – External Audit Consultation Paper*, October 2008, p. 21.

³⁹ See International Auditing and Assurance Standards Board (2008) *Strategy and Work Program, 2009-2011*, July, p. 19.

⁴⁰ Nugent, Michael (2008) *Issues Paper – Emissions Assurance*, International Auditing and Accounting Standards Board, <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4372>, p. 9.

⁴¹ <http://www.charteredaccountants.com.au/A121588543>.

⁴² <http://www.linfox.com/~media/Documents/PDF/National%20Greenhouse%20and%20Energy%20Reporting%20Act%20factsheet.ashx>

⁴³ Department of Climate Change (2009) *Draft Carbon Pollution Reduction Scheme Bill 2009 Fact Sheets, Liable Entities and Covered Emissions*, http://www.climatechange.gov.au/emissionstrading/legislation/pubs/liable_entities_and_covered_emissions.pdf.

⁴⁴ *Draft Exposure Bill: National Green and Energy Reporting Amendment Bill 2009*, schedule 1, part 1, section 73A-74, http://www.climatechange.gov.au/reporting/publications/pubs/ngeramendment_bil.pdf; *National Greenhouse and Energy Reporting Act 2007*, Part 6, Division 4, Subdivision G, section 73-74, [http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/8FA840AEE6E656C2CA2575780010B9F8/\\$file/NatGreenhouseEneReport2007.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/8FA840AEE6E656C2CA2575780010B9F8/$file/NatGreenhouseEneReport2007.pdf).

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⁴⁶ Department of Climate Change (2008) *National Greenhouse and Energy Reporting Act 2007 and Carbon Pollution Reduction Scheme – External Audit Consultation Paper*, October 2008, pp. 9,23-24,28.

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- ⁴⁸ Speech by SEC Chairman: Opening Statement — Open Meeting on the Use of Technology to Improve Financial Reporting by Chairman Christopher Cox *U.S. Securities and Exchange Commission* Washington, D.C. May 14, 2008 reported at <http://www.sec.gov/news/speech/2008/spch051408cc.htm>
- ⁴⁹ The SEC 's new financial reporting system is called IDEA (Interactive Data Electronic Applications). Investors can begin seeing this new information at <http://idea.sec.gov>.
- ⁵⁰ The Australian Financial Review, p.10, 22 April 2009. www.afr.com
- ⁵¹ Global Capital Markets and the Global Economy: A Vision from the CEOs of the International Audit Networks November 2006.
- ⁵² *Continuous Assured in Control – Peeking ahead in a tagged-data era* Paper by J P J (Hans) Verkruijsse PhD, RE RA, The Netherlands
- ⁵³ Ibid,
- ⁵⁴ International Auditing and Assurance Standards Board, Strategy and Work Program, 2009-2011, pp 13, 15. July 2008
- ⁵⁵ *Report to the President of the French Republic on the Financial Crisis*, September 2008, at <http://www.ifac.org/financial-crisis/>
- ⁵⁶ The Financial Stability Forum (FSF) brings together senior representatives of national financial authorities (e.g. central banks, supervisory authorities and treasury departments), international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. The Reserve Bank of Australia is represented on the Forum.
- ⁵⁷ Address To IFAC Council By Robert Bunting International Federation of Accountants Rome, Italy - November 13, 2008
- ⁵⁸ Audit Practice Alert No. 3., *Audit Considerations in the Current Economic Environment* (December 5, 2008) (See http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2008/12-05_APA_3.pdf)
- ⁵⁹ PCAOB Prepared Remarks by PCAOB Chairman Mark W Olson, The 2009 Ken Spencer Memorial Lecture, Melbourne, March 11, 2009, "The Audit Profession and the Evolution of Independent Oversight"
- ⁶⁰ "The new ASIC: Addressing today's challenges and building for the longer term", Speech by Tony D'Aloisio, Chairman Australian Securities and Investments Commission, to the Australian Corporate Lawyers Association (ACLA) Friday, 7 November 2008
- ⁶¹ Laurie Brannen, Business Finance Magazine, 6/1/07 "Top of Mind; Is a forensic audit in your future?"
- ⁶² P2 (v) US Treasury Department October 6, 2008.
- ⁶³ IAASB Annual Report 2008, Report of the Chairman, John Kellas.
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- ⁶⁶ PCAOB Prepared Remarks by PCAOB Chairman Mark W Olson, The 2009 Ken Spencer Memorial Lecture, Melbourne, March 11, 2009, "The Audit Profession and the Evolution of Independent Oversight"
- ⁶⁷ *The Audit Quality Framework*, (UK) Financial Reporting Council, February 2008 was published following consideration of an earlier discussion paper *Promoting Audit Quality* released in November 2006.