



International Symposium on Audit Research (ISAR)

Enhancing Financial Reporting & Assurance: Current Developments, Challenges & Research Opportunities

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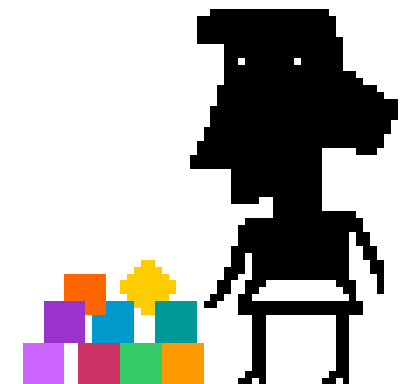
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Structure of the presentation

- Structure of the Profession
 1. EU Green Paper
 2. House of Lords
- Extending Financial Reporting: Audit Implications
 3. IAASB Discussion Paper
 4. International Integrated Reporting Committee
- International Regulatory Initiatives
 5. International Forum of Independent Audit Regulators (IFIAR)





1. EU Green Paper Audit Policy: Lessons from the Crisis

Following Global Financial Crisis, EU Commission keen to assume leadership on the debate on the role that auditors can play to increase financial stability

- Role of Auditor
- Governance & independence of Audit Firms
- Supervision of auditors
- Concentration & structure of audit market
- Creation of single market for provision of audit services
- International cooperation for the supervision of global audit network





Role of Auditor

■ Higher level of assurance to stakeholders

- Should be very high assurance on components of balance sheet & their valuation.
- Consider going “back to basics”, more substantive verification of Balance Sheet and less reliance on compliance and systems work (can be covered by Internal Audit)
- Disclose components directly verified, and which verified on basis of judgement, models & management expectations

■ Qualified Audit Reports

- Negative perceptions attached to qualified audit report
- Unlike ratings agencies, no categorisation by auditors of clients





Role of Auditor (cont.)

■ Better external communications

Can we improve the overall communication process to increase value added by audit?

- E.g. French Commercial Code requires auditors to publicly justify their position, including appreciation of choice of accounting methods, and material sensitive accounting estimates

■ CSR Information

Important to have relevant and reliable information to contribute to better valuation of EU companies. CSR information is being shown to aid this. Should this information be audited?





Governance & Independence of Audit Firms

- Appointment and remuneration of auditor
 - Consider whether appointment, remuneration and duration of engagement should be the responsibility of a regulator
- Mandatory rotation of audit firms?
- Prohibiting auditors from offering NAS to audit clients?
- Group audits: large group audits usually undertaken by large global networks.
 - Role of group auditor needs to be reinforced.
E.g. Access to reports and documentation of all auditors who are assuring sub-entities





Concentration & Market Structure

- Very concentrated. Audits of listed companies by Big 4 in terms of client revenue is commonly $>90\%$ in many countries
 1. Joint Audits – appoint two firms who share the work and jointly sign the report. Consider at least one non-Big 4 audit firm for audits of large companies
 2. Mandatory rotation of audit firms
 3. Are Big 4 really the best auditors or just perception?
- Increasing International Cooperation
 - Consider exchange of audit working papers between European oversight bodies and other counterparts in third countries.





2. UK House of Lords: Select Committee on Economic Affairs

Auditors: Market Concentration & Their Role

- Concern about the dominance of the Big 4 and effect on competition and choice
- Identified the audit market as an oligopoly with concerns about competition, choice, quality and conflicts of interest, as evidenced by failure to warn of the banking crisis
- Big 4 in UK in 2010 audit 99 of FTSE100, and these companies change audit firm on average every 48 years.
- Banks in UK audited only by Big 3. Even less competition





Considerations

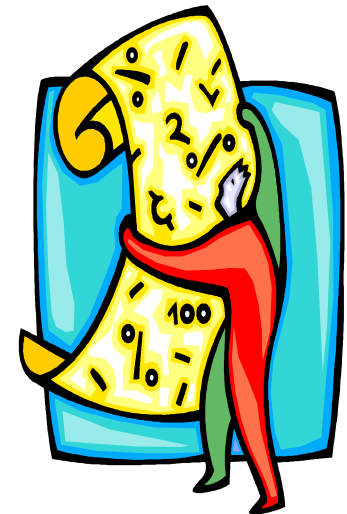
- Although auditors have to be careful about expressing concern openly on bank finances (in audit report), critical that confidential dialogue between bank auditors and regulators had fallen away just before the crisis
- Report complementary of FRC's recommendations to reducing risk and bolster competition in the audit market, including a report by audit committee explaining choice of auditor, and encouraging shareholders to take greater interest in auditor selection
- Considerations given to
 - Breaking up Big 4 firms (radical)
 - Joint audits
 - Regular mandatory tendering of audit contracts





3. IAASB Discussion Paper: Evolving Nature of Financial Reporting – Disclosure & Its Audit Implications

- The evolving nature of financial reporting: disclosure and its implications
 - Recognise that there is a large increase in financial reporting **disclosure** practices – more than financial line items, but includes disclosures of assumptions, models, alternative measurement bases and sources of estimation uncertainty
 - Under ISAs required to address RMM of disclosures at the assertion level. But is this done to same extent as financial line items?





Recent Concerns Expressed about Audit of Disclosures

- Recent GFC, perceptions that auditors did not exert enough effort in auditing disclosures
- Suggestions that auditors need to use greater judgement and professional scepticism in this area
- Issues raised include
 - What does sufficient appropriate audit evidence mean for disclosures?
 - How does materiality apply to disclosures?
 - How are misstatements evaluated?
 - Are there types of disclosures that are not auditable?
What to do with these?

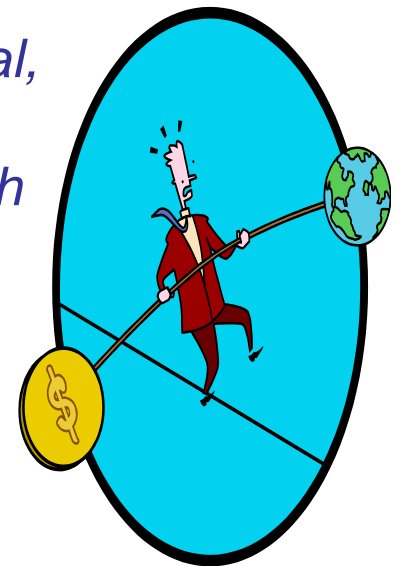




4. The International Integrated Reporting Committee (IIRC)

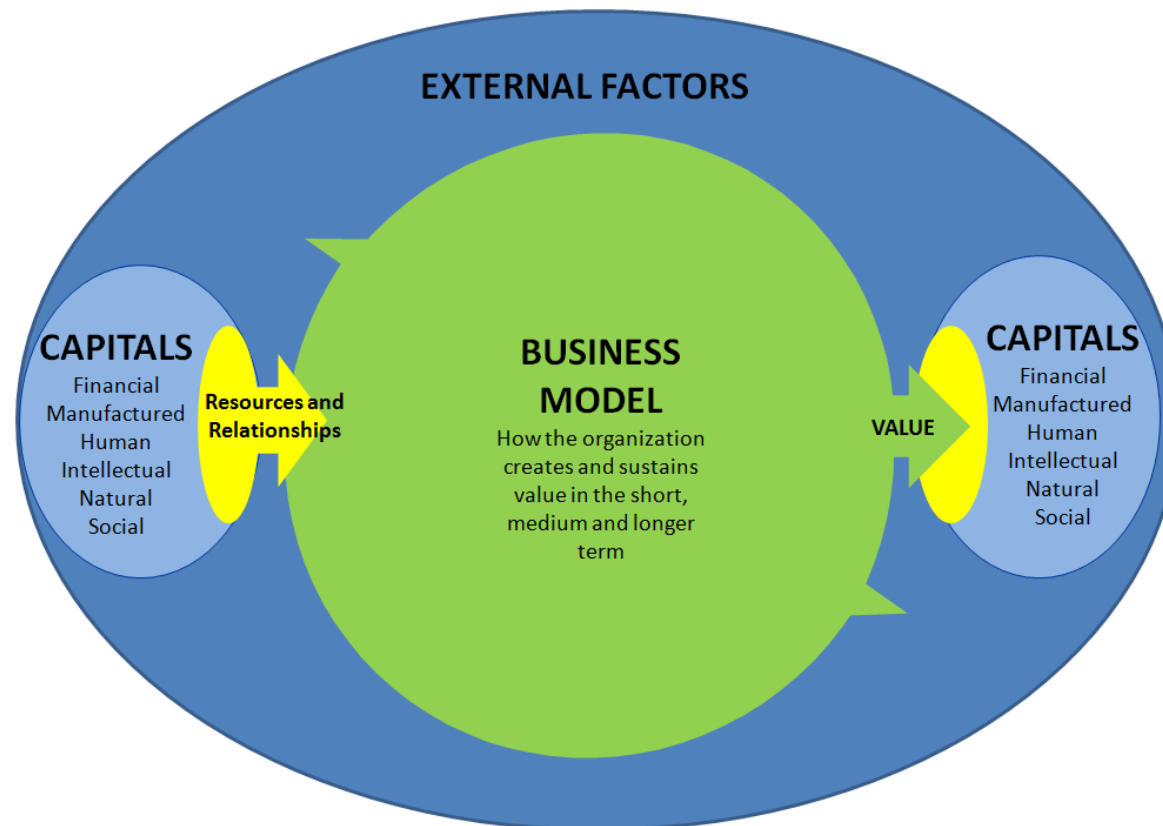
The IIRC was established in 2010 with the following mission:

- *“To create a globally accepted Integrated Reporting Framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format. The aim is to help with the development of more comprehensive and comprehensible information about organizations, prospective as well as retrospective, to support the transition to a sustainable global economy.”*





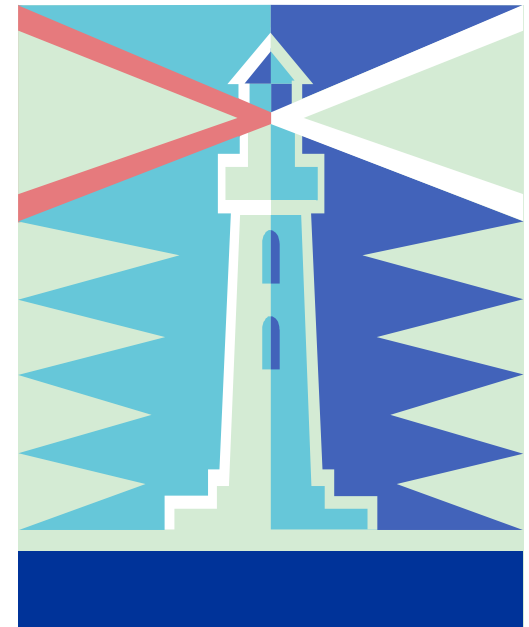
An Example of an Integrated Reporting Model





Principles for Integrated Reporting

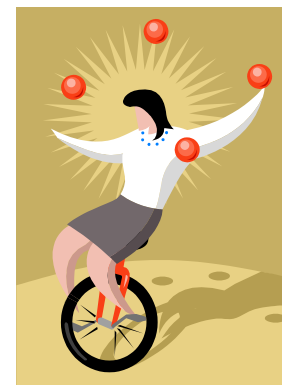
- Strategic Focus
- Future Orientation
- Connectivity of Information
- Responsiveness and Stakeholder Inclusiveness
- Medium-term Outlook





What are “The Capitals”

- **Financial capital:** The pool of funds that is available to the organisation for use in the production of goods or the provision of services.
- **Manufactured capital:** Manufactured physical objects (as distinct from natural physical objects) that are available to the organisation for use in the production of goods or the provision of services
- **Human capital:** People’s skills and experience, and their motivations to innovate
- **Intellectual capital:** Intangibles that provide competitive advantage
- **Natural capital:** Natural capital and the natural processes that generate them, including air, water, land, biodiversity, eco-system health, and natural sources of energy.
- **Social capital:** The institutions and relationships established within and between each community, group of stakeholders, and other networks to enhance individual and collective well-being, which together support the business model.





5. International Forum of Independent Audit Regulators (IFIAR)

- IFIAR forum brings together regulators from 37 jurisdictions
- Aim:
 - Regulators to share knowledge of audit market environment
 - Promote collaboration in regulatory activity
- Attempts to address the concern that we have international clients, international audit firms, international standards, but national regulation
- Main activity is inspection reports but little is known about how they are undertaken and how effective these are
 - How do regulators assess audit quality?
 - Compliance with auditing standards is the common answer
 - What are we seeing? Increased emphasis on documentation of procedures and policies by auditors, but is this having a true effect on audit quality? Many say they are, but in reality we do not know.

