

STUDY GUIDE A1: INTERNATIONAL REGULATORY FRAMEWORKS FOR AUDIT AND ASSURANCE SERVICES

Get Through Intro

A strong regulatory environment and corporate governance have become key terms in today's business world. They help reassure the various stakeholders of companies, who have become highly sceptical about the intentions of management because of the multitude of recent high profile financial scandals.

Organisations today are expected to be well regulated and ethically run in terms of both their operations and their financial reporting. Good corporate governance requires directors to be more involved in overseeing the organisation in terms of the reliability of its financial reporting and the ethicalness of its actions.

Towards this end, there has been a push for the adoption of a uniform set of auditing standards and corporate governance regulations across the globe. The growth of multinational companies has also contributed to the growing demand for international standards. International Standards of Auditing are now fast emerging as globally accepted standards which provide recognised benchmarks for all nations.

This Study Guide will provide you with an understanding of the need for a regulatory framework and its effectiveness. It is a significant Study Guide for you to understand and remember, because you will be regulated by these standards when you become an auditor!

Learning Outcomes

- a) Explain the need for laws, regulations, standards and other guidance relating to audit, assurance and related services.
- b) Outline and explain the need for the legal and professional framework including:
 - i. public oversight to an audit and assurance practice.
 - ii. the role of audit committees and impact on audit and assurance practice.

Introduction

Case Study

Numerous financial scandals have reduced the credibility of the accounting and auditing industry. The International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB) are making efforts to rebuild the lost confidence.

The IAASB is influenced by globalisation and international convergence while preparing International Standards on Auditing (ISAs) and emphasis is given to harmonising the ISAs with national auditing standards. Auditing standards related to risk assessment, risk management and corporate governance have been given high priority.

According to IFAC 2007, more than 100 **countries** are currently applying, or are on the brink of **adopting**, ISAs as their national auditing rules.

The above extract shows the importance of regulation in the field of auditing and the growing importance of ISAs. As an auditor remember that a lot of people are relying on your judgement so ensure that you understand and implement the requirements of the ISAs!

1. Explain the need for laws, regulations, standards and other guidance relating to audit, assurance and related services.^[2]

[Learning Outcome a]

The terms audit, assurance engagements etc. have already been explained in detail in Paper F8. This is a quick revision of these terms.



An **audit** provides a high level of assurance that financial statements are free of any material misstatement.

An **assurance** is an assertion that the statements presented are correct. In an assurance engagement, a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users.

An assurance engagement is conducted to provide:

- a **high level of assurance** that the subject matter conforms with the suitable criteria. For example, an audit engagement where the auditor provides positive assurance on the presentation of the financial statements.
- a **moderate level of assurance** that the subject matter is plausible in the circumstances. For example, a review engagement which provides a moderate level of assurance to readers on the reliability of the financial information. The report essentially states that nothing has come to the reviewer's attention to indicate that the financial information is not presented fairly in accordance with GAAP.

Tip

Criteria are the benchmarks used to evaluate or measure the subject matter.

Suitable criteria exhibit relevance, completeness, reliability, neutrality and understandability.

Other **related services** include compilation and agreed-upon procedure engagements where no assurance is provided.

Remember, in an engagement for the compilation of financial statements, an accountant prepares or assists in preparing financial statements without expressing any assurance.

Audit, assurance and other related services are regulated by laws, regulations, standards etc.

Example

The following are some examples of the laws, regulations etc. which regulate audit and related services:

Laws: Companies Act, Finance Act etc.

Standards: Auditing standards, accounting standards (both national and international) etc.

Regulations: Ethical regulations such as Code of Ethics, professional regulations such as auditing standards, regulations of ACCA.

The above example shows that audit, assurance and other related services are regulated by various laws, regulations, standards, guidelines etc. One question which arises here is why is it necessary to regulate audit, assurance and related services when these are provided by professional accountants (who have already acquired a professional degree and are assumed to have the requisite knowledge and skill)? Is it really necessary to regulate these services?

Yes. The failures of big **entities** such as **Enron** have **highlighted the need for a regulatory framework**. As a backlash against the multitude of recent high profile financial scandals such as that of Enron, where the auditor, Arthur Andersen was also found guilty for destroying the important papers and for gross negligence, regulation of audit and related services is now being demanded by the stakeholders of organisations such as shareholders, investors, account payables and even the society at large.

Tip

The IAASB's Standards contain **basic principles and essential procedures (identified in bold type lettering)** together with **related guidance** in the form of explanatory and other material including appendices.

Audit, assurance and related services should be regulated for the following reasons:

Reasons for regulating audit and related services

1. To protect the public interest

An auditor has a duty to prevent the general public from being deceived. People rely on audited financial statements while taking major decisions such as the sale or purchase of the shares of an entity.

The laws, regulations and standards assure the client and the users of financial statements that the auditor's work meets high professional standards. Regulation of an audit is necessary to assure the public of the auditor's professional attitude and standard of work.

For example, most national laws governing audit require that the statutory auditor should not provide other consultancy services (such as valuation of inventory and bookkeeping) to the audit client so as to maintain his independence. This is because a person who is not independent may not give an unbiased opinion and this may affect the decisions taken on the basis of the opinion expressed by the auditor.

2. To maintain the dignity of the profession

The professional body to which the auditor belongs is held in high esteem by the society. The members of the body should act in a manner which upholds the dignity and integrity of the profession. In order to ensure this, these bodies make it obligatory for its members to follow certain regulations such as a Code of Ethics.

For example, The Code of Ethics of the ACCA sets out the fundamental principles which all the members of the ACCA are obliged to follow. Disciplinary action is taken against a member who does not follow these principles. In addition, if a member of the ACCA has any ethical problem, he may talk to an ACCA technical advisor who will provide guidance on the interpretation of the ACCA's Rules of Professional Conduct and ethical issues.

3. To reduce risk and increase public confidence

Although these regulations do not eliminate the risk to the public, they act as a check on the auditor and therefore increase public confidence in the audit reports provided by the auditors.

For example, the Companies Act of most countries gives qualifications and disqualifications for auditors (i.e. who can and cannot be a statutory auditor of a company). These requirements ensure that the auditor is a competent and independent person and increases the public's confidence in the audit reports.

4. To act as a guide for auditors and bring uniformity in the audit

Auditing standards provide guidelines for an auditor to follow while performing an audit. This also brings uniformity in the work of the auditor. When the auditors of two different organisations follow the same accounting standards, it facilitates better comparison among the organisations.

5. To enhance the quality of the work

These laws, regulations, auditing and accounting standards and other guidelines enhance the quality of the work by monitoring, regulating and guiding professional accountants.

For example, ISA 220 provides guidance on quality control of the policies and procedures of an audit firm in general, and of the procedures regarding the work delegated to assistants on an individual audit.

In addition, although an auditor possesses basic professional qualifications, due to the continuous updates to and the complexity of the services provided, it is necessary to provide auditors with some guidance. Standards provide this guidance to them.

2. Outline and explain the need for the legal and professional framework including:^[2]

- i. public oversight to an audit and assurance practice.
- ii. the role of audit committees and impact on audit and assurance practice.

[Learning Outcome b]

2.1 Need for a legal and professional framework

Learning Outcome 1 clearly states the reasons for regulating audit and related services. The need for legal and professional framework arises because of these same reasons. Legal and professional frameworks are put in place to ensure compliance with laws, regulations, standards and related services.



2.2 Public oversight to an audit and assurance practice

Earlier, the accountancy profession was self-regulated. However, due to globalisation and the failure of big organisations such as Enron the effectiveness of self-regulation came into doubt and a need for external regulation emerged.

A public oversight committee is an **independent body created to oversee the governance and financial reporting of public organisations**. Its main role is:

- to protect the interests of investors and the public at large.
- to give investors and others confidence that an organisation's activities are not detrimental to the public interest.
- to ensure that the audit report is fair and independent, providing all the essential information.
- to ensure that registered public accounting firms maintain high professional standards so as to improve the quality of audit services offered.

Example

The Public Company Accounting Oversight Board was set up by the **SOA (Sarbanes-Oxley Act 2002)** to supervise the auditors of public companies. All public accounting firms are required to register with it. It was set up to protect the interests of investors and the public. Its main function is to supervise the audit of public companies (that are subject to securities law) by ensuring that the audit reports are accurate and independent.

Diagram 1: Public oversight

