

**CPA Australia Congress Canberra 20th October 2020**  
**The Annual Allan Barton Memorial Research Lecture**  
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**Australian Auditing and Assurance Standards Board**  
**Maintaining Confidence in Audit in a Changing World**

I would like to begin by acknowledging the traditional custodians of the land on which we meet today, the Ngunnawal people, and pay my respects to their elders past and present and those emerging.

I am very honoured to have been asked to present this memorial lecture in recognition of Professor Allan Barton, in what I believe is the 8<sup>th</sup> such memorial lecture, in a long history of such lectures before being named in memory of Professor Barton. His work in the field of public finance and government accounting has placed Australia at the forefront of these policy areas. There is a current mantra in academia that our research should be impactful, meaning that it should inform current debates and decision-making, and Professor Barton was a leading exponent of this type of research.

I first met Professor Barton when I was starting my academic career at Monash University in the early 1980s, and he was visiting that institution. I remember him seeking me out to talk about my research and general research interests, and my aspirations as a future academic. It was an inspirational moment for me, and he took the time to follow up at conferences, to see how my academic career and research was progressing. These kind moments, with such a leading academic, leaves a lasting impression, something that I can only wish in some way to emulate.

## **1. Introduction**

So let me talk to the topic, 'Maintaining Confidence in Audit in a Changing World'. The world is currently in the midst of a global pandemic as COVID-19 impacts our way of living and personal freedoms. We are in an environment of change as the world adapts to the impact of this virus. We were already experiencing a changing landscape and in many ways from a societal perspective, a crisis of trust. As we rebuild trust, or confidence in high quality information in this era of "fake news", the value of credibility enhancing techniques such as audit and assurance, are more important than ever.

The significant turmoil across the world will, and already has, changed ways of life and work. The social and economic consequences of the COVID-19 pandemic have been extreme, and the policy and economic decisions that have been made and will be made in the coming months, by those we have elected to govern our economy and lives, and those that lead our entities, will have long-term impacts across all areas of social and economic life. Across the world we have seen the ceding of extraordinary powers to those in decision-making positions in order to react in the best interests of their communities, as they balance health and economic considerations. Although immediate reaction was required, it is at times such as we live in now that check and balances on these powers, and investments in these checks and balances, become even more important.

While I will touch on these points I need to dig deeper into the title, as even before the pandemic struck we were already into a change revolution, facilitated by an information technology (IT) evolution, where traditional business models and structures were under threat and information on a broader range of accountabilities were being sought. This would have been a major focus when this lecture, the changing environment, was determined. The current crisis has accelerated change, and resulting policy initiatives have impacted many businesses very deeply. Some have prospered by being in the right place at the right time, or being adaptive or further along the change route with their business models, while unfortunately many may not survive the business environment that on the other side of this pandemic. As a University professor, I am involved in a sector which is significantly impacted. The institution that I am at will remain, but it is likely to a very changed institution to that which existed before the pandemic.

So, as stated, when the committee approached me with the topic, “maintaining confidence in audit in a changing world”, we were already in a changing landscape and in many ways a crisis of trust, and the looming pandemic and consequences were not front of mind. Some of those drivers of changes include:

- The trust deficit, especially for public institutions, and corporations, and the impact on accounting and auditing;
- A global trend on the information needs of stakeholders representing accountability on a broader array of subject matter, including environmental, social and governance (ESG) information and other non-financial information which is demanding more reporting on these matters and related credibility-enhancing techniques; and

- The impact of the IT revolution, which has potential multiple effects, such as increasing information that is available for decision-making, the way that information is provided, and impacts related credibility enhancing mechanisms such as auditing and assurance, including impacting the process by which credibility-enhancing mechanisms such as audits are undertaken.

Although I will be talking about the trends affecting the auditing profession, and particularly the impact on the Auditing and Assurance Standards Board (AUASB) in setting auditing and assurance standards, where there are opinions offered, these opinions are my personal views, and do not represent the views of the AUASB. It should also be noted that AUASB standards are sector and framework neutral standards. Thus I will explore these drivers of change, and consider their impact on the three sectors, the for-profit sector, the government sector, and the private not-for-profit sector, and pay particular attention to how we maintain confidence in audit and assurance in view of these changing trends.

The structure of the paper is as follows. It will:

- examine the drivers of the trust crisis and their relation to audit in the changing environment;
- consider the impact on information needs and the consequential opportunity for auditing to increase confidence as a credibility enhancing technique;
- examine the changing environment for financial reports, current auditor initiatives and related research opportunities;
- examine the changing environment for non-financial information, current auditor initiatives and related research opportunities;
- identify and examine special audit and assurance considerations and initiatives in the Private not for-profit sector and the Public sector;
- examine how auditing and the auditing standards have stood up under the pressure of the COVID-19 pandemic and have contributed to confidence in the capital markets; and
- finally, conclude.

## **2. Drivers of the trust crisis**

Public trust in the contribution, accountability and integrity of business has been declining over the last couple of decades (Edelman, 2020). For 20 years, the Edelman Trust Barometer has gauged trust by asking: “How much do you trust this institution to do what is right?” Given the general

population's overall lack of trust and a pronounced sense of inequity, the 2020 Trust Barometer sought to understand what shapes the public's view of "to do what is right." The analysis identified that trust is built on two key drivers: competence and ethical behaviour.

The findings for Australia are at least worrying, and potentially alarming. No type of institution was viewed as both competent and ethical. Business was viewed as the only competent institutions, but was not viewed as ethical. Non-Government Organisations are seen as the only ethical type institution, with Government organisations and media are viewed as neither competent or ethical.

Public perceptions of trust are fuelled by media attention, with media bringing a blowtorch to instances of poor behaviour. In Australia there have recently been a number of high profile instances of poor corporate behaviour which have severely negatively impacted trust in large corporates, as evidenced by such actions as the findings from the recent Banking Royal Commission, banks failing to report to the regulator transactions that potentially supported illegal activities; and a mining company involved in the desecration of an Aboriginal sacred site.

Australia is not alone in experiencing these behaviours. Internationally we have seen the financial collapse or alleged fraud of some very large organisations, including Carillion in the UK and Wirecard in Germany. These collapses, and the related Australian corporate behaviours outlined, have raised questions about the role and value of audit.

So, from a societal perspective, how do private and public institutions win back this trust, and what is the role of auditing in this environment? Figure 1.1 shows the importance and roles of accounting and auditing in rebuilding trust. While it is important in the first stage for institutions to do the right thing, not only because it is legally required but rather because it reflects the right ethical behaviour, this will only build trust if results of this behaviour and effectively communicated and are seen to be credible. The purpose of audit is to enhance confidence so it must have a role. At the moment the financial report is the only corporate report subject to audit. However, information users are increasingly looking to the reporting on non-financial information such as ESG matters and in Australia this is currently not required to be assured. What information should be subject to assurance, and what form should it take in the current environment are questions that need to be addressed.

<INSERT FIGURE 1.1 HERE>

### **3. Changing information needs and the consequential impact on auditing as a credibility enhancing techniques**

As said, the accountabilities of organisations for resource usage, and to demonstrate their societal value are expanding, and accounting and auditing have to evolve in order to meet these information needs. I will concentrate on three categories of public reports produced under accepted frameworks, and the differential auditing and assurance requirements associated with these categories. Thus there:

- The financial statements contained in annual reports and related financial information contained in interim reports, which is covered by our auditing standards, Australian Standards on Auditing (ASAs) and Australian Standards on Review Engagements (ASREs);
- Other information contained in annual reports, which is covered by the auditing standard ASA 720 “The Auditor’s Responsibilities Relating to Other Information”, and can potentially be assured under the Australian Standards on Assurance Engagements (ASAEs)
- Other publicly available reports, including General purpose reports such as Environmental, Social and Governance (ESG) reports, Integrated Reports (<IR>), Corporate Social Responsibility (CSR) reports or Performance Statements; (or more specific purpose reports such as Modern Slavery Reports or Climate Change Reports), which can potentially be assured under the Australian Standards on Assurance Engagements (ASAEs)

I do recognise that there is other information made available to the market, which could also be subject to credibility enhancing techniques, and other information used internally, which again may be a consideration for credibility enhancing techniques.

You will note that in all of these areas the primary response to the changing environment would be driven through changes to reporting frameworks. It is incumbent on auditing and assurance techniques to keep up to date with these evolutions in reporting frameworks.

While reporting frameworks may differ between the three sectors, assurance frameworks as mentioned earlier are sector neutral. Again there can be differences, on the types of engagements (e.g. performance information results in a different emphasis and likelihood of take up for performance audit standards), or specific areas (such as going concern, or engagement acceptance), but by and large any developments in auditing and assurance standards will relate to all sectors.

#### **4. The changing environment for financial reports, current auditor initiatives and research opportunities**

Auditors provide confidence that there is not a material departure from the applicable reporting criteria. If for example, the reporting criteria become more complex, so to does auditing. An overall theme of the recent PJC hearings has been the complexity of recently revised accounting standards, including AASB 15, covering revenue from contracts with customers; AASB 9, covering financial instruments spanning loans, receivables and hedge accounting; and AASB 16, covering leases. One of the underlying themes of these revisions to accounting standards is to attempt to better reflect economic reality, and capture future benefits and obligations. This has resulted in greater emphasis on measuring future benefits or expected future cash flows. At times of greater future uncertainty, such as the Global Financial Crisis, or COVID-19, this subject becomes more complex and difficult to measure, report, and therefore to audit. A reasonable response is increased disclosures around these greater uncertainties and risks, and again increased complexity to audit.

How have the auditing profession responded to this and the changing environment? Although Australia are one of the few countries whose auditing standards have the force of law, the AUASB has a directive from the Financial Reporting Council to align with the international standards, unless there is a compelling reason not to do so. Thus you will see close alignment of the workplans of the International Auditing and Assurance Standards Board (IAASB) and the AUASB, identifying areas (on a continuous improvement basis) where there are potential needs to revise the standards in order to maintain and enhance confidence in audit.

The following projects are also in progress with the objective of enhancing audit quality:

##### **4.1 *Changing audit environment and greater regulatory focus***

Audit regulators have an important role in monitoring the quality of audits through inspection of audit files. The role of the International Federation of Independent Audit Regulators (IFIAR), and their focus on independent inspection findings is one of the most commonly referred to measures of audit quality. Whilst it is broadly recognised that regulator inspection findings are only one measure of audit quality, regulator's findings have generated significant media attention and have arguably been a significant driver of the public's perception of audit quality and the

confidence they have in the value of audit. Internationally and in Australia (with the Australian Securities and Investments Commission (ASIC) being the IFIAR regulator in this country), the results of these inspections have consistently been below what is considered satisfactory.

A negative inspection finding on an audit file indicates that, in ASIC's opinion, there is a departure from approved auditing standards. There are a number of possible reasons for this:

- The auditor may have clearly not followed the requirements of the auditing standards;
- The auditor and ASIC may disagree as to whether the auditing standards have been followed. Auditing standards are principle-based, rather than rules-based, and it is recognised that within the range of audit firm methodologies there are different auditing approaches to addressing various identified audit risks, and achieving the principles in the auditing standards: or
- There is a lack of clarity in the auditing standards as to what is required.

In Australia the AUASB sets the auditing standards, and ASIC enforces the auditing standards. This is consistent in concept in Australia where the setting of legal requirements is kept separate from the policing of these requirements. The AUASB has a clear interest in understanding these different categories of inspection findings, but especially the third category, where there is a lack of clarity as to the requirements in the auditing standards.

As such, the AUASB is working with both ASIC and the major auditing firms to identify areas where further clarification of the requirements in the Auditing Standards would be beneficial. We are working around the areas of major categories of findings, rather than one off findings. For example, as a result of this process, the AUASB (2020b) has recently revised GS 005, *Evaluating the Appropriateness of a Management's Expert's Work*, to clarify the audit requirements around this category of findings.

Being one of the most publicly observable measures of audit quality, inspection findings have received a lot of attention at the recent Parliamentary Joint Committee (PJC) Inquiry into Regulation of Auditing in Australia. It is agreed that inspection findings by their nature (for example being risk based, and not random), do not allow the identification of improvements in audit quality across time. For example, two other possible reasons for a higher identification of adverse inspection findings may be more complex subject matter over time (the introduction of more

complex accounting standards), or increased experience of the inspectors at identifying areas of risk. On the converse, the experience of the audit firms from working with inspectors may result in audit firms becoming more experienced as to the types of clients and auditors that are likely to attract inspector attention. This may or may not reflect an improvement in underlying audit quality.

Changes are being observed which should provide more transparency about the inspection findings and enhance the evaluation of audit quality. These include:

- Greater attention being paid to a broader range of audit quality measures, with ASIC constructing a scorecard of audit quality metrics. An example of a metric is the response to perceptions of audit quality by the Chairs of Audit committees, which is undertaken jointly by the Financial Reporting Council (FRC) and the AUASB. While each individual metric may be open to criticism, it is argued that a balanced scorecard of metrics will promote a greater understanding of underlying audit quality and trends;
- Enhanced disclosures of audit quality findings, voluntarily by audit firms and also considered by ASIC, which permits greater public scrutiny of these findings;
- Attempts at classifying the severity of inspection findings. At the extreme, it is agreed that a severe inspection finding is one which would either result in the auditor changing their audit opinion, and/or the client restating their financial results. The second category, at least where a client is required to restate their financials, is very rare in practice, but this restatement figure receives little public (press) attention.

Inspection findings are by regulation concentrated at larger listed entities, and these draw the most public interest attention. These large entities are also by nature some of the most complex in organisational structures and accounting issues faced. They tend to be dominated by the Big 6 audit firms, with a much lower proportion of ASIC inspections undertaken outside the Big 6. ASIC Report 648 issued in December 2019 outlined the findings from ASIC's inspections of 19 Australian audit firms undertaken in the 12 months to 30 June 2019, with 44 of the 58 audit files reviewed undertaken by one of the Big-6 audit firms. Anecdotally there are issues of concern around accounting quality and consequential audit quality raised at the smaller end of the listed entity market, but little inspection activity occurs here.



Outside the listed entity space there is little incentive for auditors of public interest entities to voluntarily undertake or request inspection findings, and there are limited resources available to undertake such inspections. We are aware that the ANAO has recently engaged ASIC to perform inspections of some of the major government owned corporations under its audit mandate, and we welcome these voluntary type initiatives.

From a research perspective, with so many changes, and so much more information publicly available, there are many research opportunities arising. More needs to be done to understand regulator findings and whether they are truly a finding that the auditor did not comply with the auditing standards, or whether the auditor and the regulator have a different professional judgement as to how to treat an item or the sufficiency of the evidence obtained (Taylor 2020).

## **4.2 *Changing auditing standards***

As outlined earlier, you will see close alignment of the workplans of the IAASB and the AUASB. The most recent standard setting activities have focused heavily on enhancing Auditing Standards to address audit quality concerns. This has resulted in a number of Auditing Standards being extensively re-written and re-issued, including those standards that address quality management practices at the firm level, and standards covering the identifying and assessing risks of misstatement, audit of accounting estimates, and group audits. These are “core” auditing standards and will impact all audit firms and engagements with the objective to improve audit quality and in turn confidence in audit.

Internationally the IAASB has recently approved what is called the Quality Management suite of standards (ISQM 1, ISQM 2 at the audit firm level, and ISA 220 at the audit engagement level), to replace the existing global quality control standard. This will bring additional rigour to the quality management practices of auditing firms, shifting the focus from quality control and compliance to firm wide quality management activities which are risk based and tailored to a firm. This by design is aimed to address key factors in audit quality.

The accounting standards have been examined for increased complexity, and so too should the auditing standards be. The auditing standards are principles based with the objective that they can be applied for all audits, regardless of sector or size of the entity. However, this is being increasingly challenged as large international entities become more and more complex and with the increased regulator focus. This has resulted

in the auditing standards becoming more and more complex. For example, the two most recently revised auditing standards ASA 315, Identifying and Assessing the Risks of Material Misstatement (AUASB 2015a and 2020a) and ASA 540 Auditing Accounting Estimates and Related Disclosures (AUASB 2015b and 2018) have seen increases from:

Standard	Intro and requirements paragraphs	Application material paragraphs	Pages (% increase)
ASA 315 (2015a)	32	155	50
ASA 315 (2020a)	38	241	108 (216%)
ASA 540 (2015b)	23	51	41
ASA 540 (2018)	39	145	61 (48.8%)

These standards are core auditing requirements and reflect increasing/enhanced auditor requirements to auditing in a changing environment. In the current world there is a risk that certain auditors will believe they understand the auditing standards and may not reflect on the change in the requirements in these standards. In larger audit firms these changed auditing standards will be reflected through changes in firm methodologies, for the international firms global methodologies, and the risk is diminished. We even hear anecdotally that individual auditors do not necessarily read the auditing standards, they expect that the firms methodologies training and decision aids will reflect current requirements.

Thus there are two related challenges to the profession resulting from the approach. The first of these is that such changes impact the supply function for auditing services, in that they potentially create economies of scale, and thus change both the incentive and ability to provide auditor services. We can see this result and this trend reflected in many countries, with auditing services being diminished as reflected in the fall of about 40% in the number of registered company auditors in Australia over the last two decades.<sup>1</sup>

The changes to the auditing standards may also impact the quality of auditor services, as the auditing standards become more difficult to navigate as to how the auditing standards are applied to individual audit standards, especially audit clients which are less complex. The IAASB recognises the challenges faced by practitioners in applying the auditing

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<sup>1</sup> In 2001 there were approximately 7000 registered Company Auditors (RCAs) in Australia (Ramsay 2001), while at June 30, 2018, this number had fallen to 4,226 (ASIC n.d.).

standards to less complex entities and are examining if the Auditing Standards are fit for purpose for all entities.

The IAASB has consulted extensively on the issues and challenges related complexity of standards, including issuing a Discussion Paper in 2019 related to audits of LCEs. Going forward, a two workstream approach has been proposed:

- Revising the ISAs to address identified challenges in applying ISAs related to complexity, understandability, scalability and proportionality (the CUSP Workstream) relevant all audits, and
- A 'Separate Standard Workstream' for the development of a separate standard to focus on addressing the challenges in applying the ISAs in an audit of an LCE, similar in concept to what is currently in place for 'IFRS for SMEs' when it comes to financial reporting.

The challenges for the CUSP workstream include identifying ways in which the auditing standards can be improved, including, for example, the way that introductory material is presented, and the role of educational material, as distinct from application material, within and outside standards. It also reflects the way that threshold terminology is used in the across the suite of standards - terms such as "reasonably possible" and "acceptably low".

The challenges for the LCE standard, for achieving the stated aim that applying this standard would result in the same level of audit quality as applying the suite of ISAs include:

- Whether, and how, the same level of assurance as that provided by an audit undertaken in accordance with ISAs can be achieved;
- how are LCEs, to which this separate standard can be applied, defined? (it is easy to define small in terms of assets, revenue or number of employees);
- how should the auditor communicate that the assurance engagement is undertaken in accordance with the separate assurance standard rather than the ISAs (e.g. does the auditor state in the auditor's report that the audit was undertaken in accordance with the separate audit standard for LCEs); and
- will users perceive the same level of audit quality for audits undertaken under the separate standard?

Thus research questions and opportunities abound, which can help inform the best way forward for addressing complexity in auditing standards.

### **4.3 Changing expectations of the auditor: Fraud and Going Concern**

Fraud and going concern are two areas continually raised as examples of audit failure as the impacts on shareholders are often financially significant. In serving the public interest the IAASB have commenced two initiatives to address issues and challenges and in particular to respond to questions raised regarding the role of auditors in these areas. Fraud and going concern are also areas raised in many of the regulatory inquiries being held internationally and the Parliamentary Inquiry into Regulation of Auditing in Australia (PJC).

One aspect common to both fraud and going concern that is continually being highlighted is the expectation gap. This has been an ongoing issue since the day audit began and is complex. Success in reducing this gap will positively influence confidence in audit. But auditors cannot do it alone. Companies, those charged with governance, investors, regulators, and others have an important role in improving reporting in relation to fraud and going concern. The respective responsibilities support and reinforce one another.

Some of the questions that are being explored in relation to fraud are:

- requiring the use of forensic specialists in a financial statement audit, and, if so, in what circumstances the use of specialists should be required;
- While financial statement audits are not designed to identify misstatements that are not material to the financial statements as a whole, the auditing standards require the auditor to evaluate whether identified misstatements are indicative of fraud and assess the impact on other aspects of the audit, particularly management representations. Questions have been raised as to whether auditors need to do more around non-material fraud. In particular, questions are being asked as to whether the auditor should have a broader focus on fraud and what additional procedures, if any, may be appropriate. Also whether additional audit procedures should be required when a non-material fraud is identified, and if so, what types of procedures.
- Given that third-party fraud is often committed in collusion with employees at the company, whether enough emphasis is placed on the auditor's responsibilities around fraud related to third parties.

Some of the questions that are being explored in relation to going concern are:

- where are changes to requirements most beneficial: accounting standards, auditing standards or management responsibilities? For example, auditors are required to consider whether events or conditions exist which cast significant doubt on the entity's ability to continue as a going concern, but management is not necessarily required to disclose such events or conditions.
- If changes are required to the auditing standards, what are these changes? For example are enhanced procedures required, and if so, should they be applied to all audits, or a subset (e.g listed entities) or should there be more or different reporting by the auditor, or should time period for consideration of such issues by management and the auditor be extended?

Again, these issues give rise to many potential research questions, which to aid evidence-informed decision-making, would be beneficial to know.

#### ***4.4 Enhanced Auditor Reporting Post implementation review***

With the objective of increasing confidence and trust in the audit process (and therefore the financial report) the format and content of the auditor's report was enhanced in 2016. Three of the main enhancements were the

- Repositioning of the audit opinion to the start of the audit report
- introducing of key audit matters (KAMs) for listed entities, and
- a reclassification of going concern uncertainties to its own section and clearly labelled as "material uncertainty related to going concern".

The IAASB and AUASB are currently assessing if these enhancements did result in increased trust and confidence in the audit process, and whether further enhancements are required to the auditor's report. This will involve extensive consultation with users to understand what they value in auditor's reporting.

Areas being considered under the post implementation review include:

- Whether the requirements for KAMs are working and should they be extended beyond listed entities. A consideration is to the broader population of public interest entities, which may well capture public-sector entities and large charities and superannuation funds. We are aware that the auditors of some of these entities are currently reporting KAMs, and would like to learn very much from their experiences. This includes how are the entities chosen for reporting KAMs, experiences in applying the auditing standards, experiences

in communicating with or influencing the disclosures of entities, and evidence of impact or effect on audit or decision-making of the reporting on KAMs;

- Whether the disclosure requirements for key audit matters should be revised or extended. For example, concerns have been raised about the use of “boilerplate” disclosures, without clarity as to what “boilerplate” is. I am aware of two commonly expressed views of “boilerplate” as being “not entity-specific, could be applied to any entity in that industry”, and “same disclosure as last year”. At the same time I am aware that a number of KAMs will carry forward from year to year, and it would not be desirable to encourage changing what may be “best disclosures”, just for sake of changing;
- KAMs can in practice be long, with quite a lot of detail around audit procedures, with guidance to the standard outlining that it is beneficial for the auditor to describe “Aspects of the auditor’s response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement; and a brief overview of procedures performed” (ASA 701.A46). In practice there is quite a range of KAM disclosures, and evidence as to what types of disclosures are most beneficial would be useful;
- Whether the auditor should conclude on specific KAMs. Currently ASA 701 does provide guidance that the auditor may provide information on the outcomes of the KAMs, “however, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that in any way may call into question the auditor’s opinion on the financial report as a whole”. We observe quite a degree of divergence on information provided on outcomes, and evidence on the effects of these divergent approaches on these outcomes would be beneficial.

## **5. The changing environment for non-financial information, current auditor initiatives and research opportunities**

In the current environment a greater range of accountabilities are being demanded by various groups of stakeholders. For example, investors are increasingly looking for non-financial information on matters such as environmental, social and governance performance when making investment decisions. From a reporting perspective this is being reflected in what has been termed extended external reporting (EER), which can play a significant role in rebuilding trust through its role in catalyzing corporate focus and disclosure of business-centric matters such as the strategy, business model and governance, on matters material to the

stakeholders of the business, and also through providing a framework for greater transparency on material non-financial matters. We can see these additional disclosure responsibilities coming through in areas like integrated reporting (<IR>), as a framework for integrating financial and non-financial information (Zhou et al. 2020), and specific issues such as climate change coming through (TCFD 2019)<sup>2</sup>.

Auditing Standard ASA 720 *The Auditor's Responsibilities Relating to Other Information, for purposes of the audit of the financial statements* (AUASB,2015b) requires that, when EER information is included in an annual report, the auditor is required to read the EER and consider whether there is a material inconsistency between that information and the financial statements, as well as the auditor's knowledge obtained during the audit. It does not constitute a separate assurance engagement on the EER. But is this sufficient for confidence in this information?

Relatedly, in Australia, it is advocated that as listed entities progressively enhance their suite of corporate reporting and share insight into their business model and strategy, which is not subject to assurance by the company's external auditor, the entity should have formal and rigorous processes that safeguard the integrity of its corporate reporting and provides the market with appropriate information to make informed investment decisions. These processes should be disclosed to assist the market in assessing the quality of the information included in these corporate reports (ASX, 2019). The recent update of the ASX Corporate Governance Council's Corporate Governance Principles & Recommendations (in the February 2019 4th Edition) has required the disclosure of the process underpinning the integrity of any periodic corporate report including integrated reports and sustainability reports, as investors are relying on a broader range of periodic corporate reports than audited or reviewed financial statements to inform their investment decisions (ASX, 2019).

The IAASB has a current project to issue guidance for assurance practitioners to enable more consistent and appropriate application of ISAE 3000 (Revised) to EER assurance engagements and greater trust in the resulting assurance reports by users of EER. This guidance is expected to be approved by the IAASB in early 2021. Specific topics on EER which are emerging as risks in this changing environment include climate related risks and cybersecurity.

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<sup>2</sup> Task Force on Climate-related Financial Disclosures. (TCFD). (2019).

Climate-related risks and other emerging risks are currently predominantly discussed outside the financial statements, if at all. However, as set out in AASB Practice Statement 2 'Making Materiality Judgements (APS 2)', qualitative external factors such as the industry in which the entity operates, and investor expectations may make such risks 'material' and warrant disclosures when preparing financial statements, regardless of their numerical impact.

Technology is becoming more and more integrated in how we do business in Australia and globally. Organisations of all types and sizes are becoming increasingly reliant on technology and being connected to the internet to operate and we have seen this move to embrace technology fast tracked during COVID-19 pandemic with it being reported that we have jumped five years forward in consumer and business digital adoption in the spaces of a few months.

The way that information is being generated and stored has significantly changed and auditors need to be aware of, and consider, the impact on information relevant to their audit. Relevant areas for an auditor to consider the impact of cyber security include fraud, controls and the impact of known data breaches on the entity. The AUASB are currently working on developing a publication to practically link cyber-security risks and the auditor's responsibilities and ensure that auditors are aware that they have a role to play in cyber-security no matter the size or complexity of the organisation.

Research opportunities abound in this area. For example, the IAASB is currently focused on developing guidance for EER assurance engagements undertaken in accordance with ISAE 3000. It has been a while since research has been undertaken on the application of ISAE 3000, and how assurance is being provided in practice (Hasan et al., 2005). Therefore, empirical evidence on the usage of ISAE 3000 in practice, and on what subject matters it is currently applied to, can provide useful insights. Also, given that assurance engagements on EER reports are commonly performed by practitioners from outside the profession, whether and how ISAE 3000 is used by other practitioners outside the accounting profession is another interesting area to explore. While an increase in the use of ISAE 3000 by other practitioners outside the accounting profession has been identified, these other practitioners do not appear to be following the requirement of ISAE 3000, in that they often fail to disclose the ethics code and quality control framework of the practitioners in their assurance reports (Ge et al., 2019).



## **6. Special audit and assurance considerations and initiatives in the Private not-for-profit sector and the Public sector**

### ***6.1 Special audit and assurance considerations and initiatives in the Private not-for-profit sector***

There has been a number of initiatives looking at the reporting framework for private not-for profit entities with the objective of improving the information being provided. This has involved a recently completed legislative review of the Charities sector with some of the recommendation designed to improve trust in charitable entities by requiring reporting on certain matters. The Australian Accounting Standards Board (AASB) is working in collaboration with ACNC, state regulators and legislators to ensure that the financial and other reporting for not-for-profit (NFP) private sector entities meets the needs of users and has more relevant and useful information and possibly including service performance reporting. The objective of the project is to develop a reporting framework that is simple, proportionate, consistent and transparent for all not-for-profit (NFP) private sector entities in Australia. Features of such a framework could include additional reporting tiers with:

- simplified recognition and measurement requirements that are capable of being audited and enforced; and
- disclosure of service performance and other information integral to financial reporting in the NFP sector, such as fundraising and transactions with related parties to the extent justified by evidence.

This accountability and transparency will help increase trust. Assurance over this information will further enhance trust. The AUASB will work with stakeholders to determine the most appropriate assurance model, including the service performance information.

### ***6.2 Special audit and assurance considerations and initiatives in the Public sector***

Relevant reporting by the public sector is an important feature of an accountable and transparent public sector. Both federal and state governments are currently embarking on large investment program to rebuild after COVID-19 and accountability about the efficiency, effectiveness and economy of the vast quantum of monies spent to aid economic recovery is important. In the public sector, there is already a broader range of accountabilities and checks and balances currently in place on top of the financial reporting requirements that large corporate entities have.

With regards to public sector financial reporting, the content of the public sector entities' reports is generally prescribed and regulated by the agency responsible for whole of government fiscal reporting and oversight (e.g. the Department of Finance, or the Treasury). Usually, in Australia, each such regulator develops a set of model financial reports (specific models are developed for specific types of public sector entities) and requires each public sector entity within the jurisdiction to report in accordance with the relevant report model. Most jurisdictions incorporate a requirement to meet Australian Accounting Standards in their legislative frameworks and so these models are agreed to comply with generally accepted accounting principles, but may narrow reporting options or change some formats in accordance with local requirements (Pilcher and Gilchrist, 2018).

With the objective of enhancing confidence by providing greater transparency in the audit process a number of Auditor-Generals have been voluntarily reporting (from the perspective of the AUASB) key audit matters in audit reports for certain public sector entities. Key audit matters communicate the matters the auditor considered the most significant and therefore focused on during the audit.

The reporting of performance is also relevant to public sector entities. Today, the reporting and accountability process in Australian public sectors includes reporting of Key Performance Indicators (KPIs). These indicators are also included in the appropriations for several Australian jurisdictions, effectively tying the financial appropriation to performance requirements—the results of which then need to be reported to the parliament—performance reporting goes hand in hand with financial reporting. For example, as discussed by Wanna (2019) in last year's Barton Memorial Lecture, for commonwealth public sector agencies the Public Governance, Performance and Accountability Act (PGPA) has sought to establish a coherent system of governance and accountability, while allowing agencies to have some freedom to customise their reporting to provide meaningful information to parliament. At the Federal level, a recent review of the PGPA Act noted the need for the AASB and AUASB to develop new reporting and assurance standards which supported the determination, measurement and subsequent assurance of KPIs for commonwealth government agencies. I note that the ANAO has recently begun a pilot of how the 'auditing' of KPIs may be implemented using existing AUASB standards, and this is a welcome development.

And of course Auditors-General also in most cases perform Performance Audits related to specific government programs or activities. In addition to identifying areas where improvements can be made to aspects of public administration, they often result in specific recommendations to assist public sector entities to improve performance. A recent, notable example of a performance audit was the ANAO's review of the Award of Funding under the Community Sport Infrastructure Program. Performance Audits. The AUASB has developed an Assurance Standard specific to the application of Performance Audits (ASAE 3500). The role of Performance Audits is a critical one that holds governments and the public sector to account, and provides confidence to citizens that government programs are being implemented efficiently, effectively and are a proper use of public funds.

Research opportunities in the private not-for profit sector and public sector abound. Building on work already done, opportunities remain for researchers to continue to consider the place of financial and performance reporting, and associated assurance techniques (Gilchrist and Simnett 2019). In the private not-for-profit sector, information is commonly voluntarily reported, and little is known about the quality of that information, the credibility-enhancing techniques that are applied, and how this information is used by report users. In the public sector, performance statements are commonly required, but little is known about the credibility-enhancing mechanisms applied and how this information is used.

## **7. How the auditing profession and the auditing standards are standing up under the pressure of the COVID-19 pandemic**

The COVID-19 pandemic resulted in significant uncertainty as to the future which made for an extremely challenging financial reporting and auditing period. In effect, the pandemic has provided the financial reporting system and auditing profession with a fairly extreme stress test. The AASB and AUASB have taken initiatives in providing guidance to financial report preparers and assurance practitioners on key considerations of the impact of COVID-19 on the financial reports and financial audits. From the perspective of the AUASB, the auditing standards have stood up to this test very well. In particular, we have noted that whilst the COVID-19 epidemic may have been the trigger to consider the requirements of many of the auditing standards, in reality a lot of the auditing issues being observed over the last 6 months are not altogether inconsistent with the sort of issues auditors regularly face each reporting period, it's just that the impact of COVID-19 has exacerbated the impact

or had companies and their management dealing with such reporting and auditing challenges for the first time.

Almost every audit would have required more detailed consideration whether the entity will continue into the future and be a going concern. For many entities going concern would not have been a risk that auditors would have had to consider in any detail. Making these assessments was very challenging. Auditors have demonstrated that they have deep skills in evaluating data and assessing feasibility of management's plan to survive. This has assisted greatly in maintaining public confidence in capital markets which is vital in Australia's economic stability.

It has been impressive how quickly auditors from all parts of the profession have quality and expertly adapted the way they performed audits in the last six months. The lack of ability to attend client's premises has resulted in the rapid adoption and transition to new technologies (e.g. doing stocktakes with the assistance of drones), and the need to obtain audit evidence electronically has added to the risks associated with the use and storage of client data. Whilst regulators allowed some minor delays in reporting for the March and June 2020 reporting seasons, auditors across all sectors have adapted quickly. Feedback is that the large firms had the resources and IT infrastructure to respond quickly, but smaller audit firms have found this more challenging. The AUASB will now work with the profession and fellow standard-setters to look at how we can benefit from this experience, and update our standards and guidance to promote greater flexibility and consistency when it comes to the use of these audit related technologies in the future.

## **8. Conclusion**

Audit quality, and the current narrative around it, must be addressed to maintain and enhance trust in the profession, especially in this changing environment. The quality of audit has been a focus of ongoing commentary and media attention globally and in Australia. As a result, a number of jurisdictions have conducted public inquiries into Audit Quality including the PJC Inquiry into Regulation of Auditing in Australia. An interim report has been issued which includes a number of recommendations which will need to be addressed in the future. The recommendations include initiatives to address concerns over auditor independence, increasing responsibilities for going concern and fraud, and increased assurance over reporting on internal controls.

The AUASB currently has a number of initiatives under way to address audit and assurance quality over both the financial and non-financial information. With regards financial information, the most recent standard setting activities have focused on enhancing Auditing Standards to address audit quality concerns. This has resulted in a number of Auditing Standards being extensively re-written and re-issued such as those that address quality management at the firms, identifying and assessing risks of misstatement, audit of accounting estimates, and group audits. These are “core” auditing standards and will impact all audit firms and engagements with the objective to improve audit quality and in turn confidence in audit. With regards future activities the AUASB is examining the learnings from audit inspection findings, and along with the IAASB are examining issues involved in the complexity, understandability, scalability and proportionality of auditing standards. There are also specific initiatives under way around group audits, and the auditors’ responsibilities in relation to fraud and going concern, and a review of whether the auditor reporting changes have achieved their intended purposes. With regards the quality of non-financial information, the AUASB and the IAASB are currently focused on developing guidance for EER assurance undertaken in accordance with ISAE 3000.

Academic research can contribute to knowledge of appropriate credibility enhancing techniques using in-depth field studies, experimental research, and, as the observations become available, archival research (Cohen and Simnett, 2015). At the individual or group decision-making level, there are numerous experimental research opportunities as to how the credibility enhancing technique is undertaken, as well as how intended users react to the technique and the way that it is reported. At the organisational level, research opportunities exist around examining how organisations make the decision to produce and assure their IR information, and other organisational characteristics that contribute to these decisions. It may be that different types of experts are involved in an EER assurance engagement, and research could examine factors and techniques, such as familiarization and brainstorming techniques, that may aid engagement team performance. At the market level, using archival research methods as the observations become available, research can examine whether organisations benefit from the different credibility enhancing techniques (Zhou et al., 2019). For example, what will be the effect of assurance on changes in share price, types of investors on share registers, or impact on accuracy (dispersion) of analysts’ forecasts. For all research methods, there are great opportunities to contribute to knowledge.

**Figure 1.1: The importance and role of reporting and credibility enhancing techniques in trust building**



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