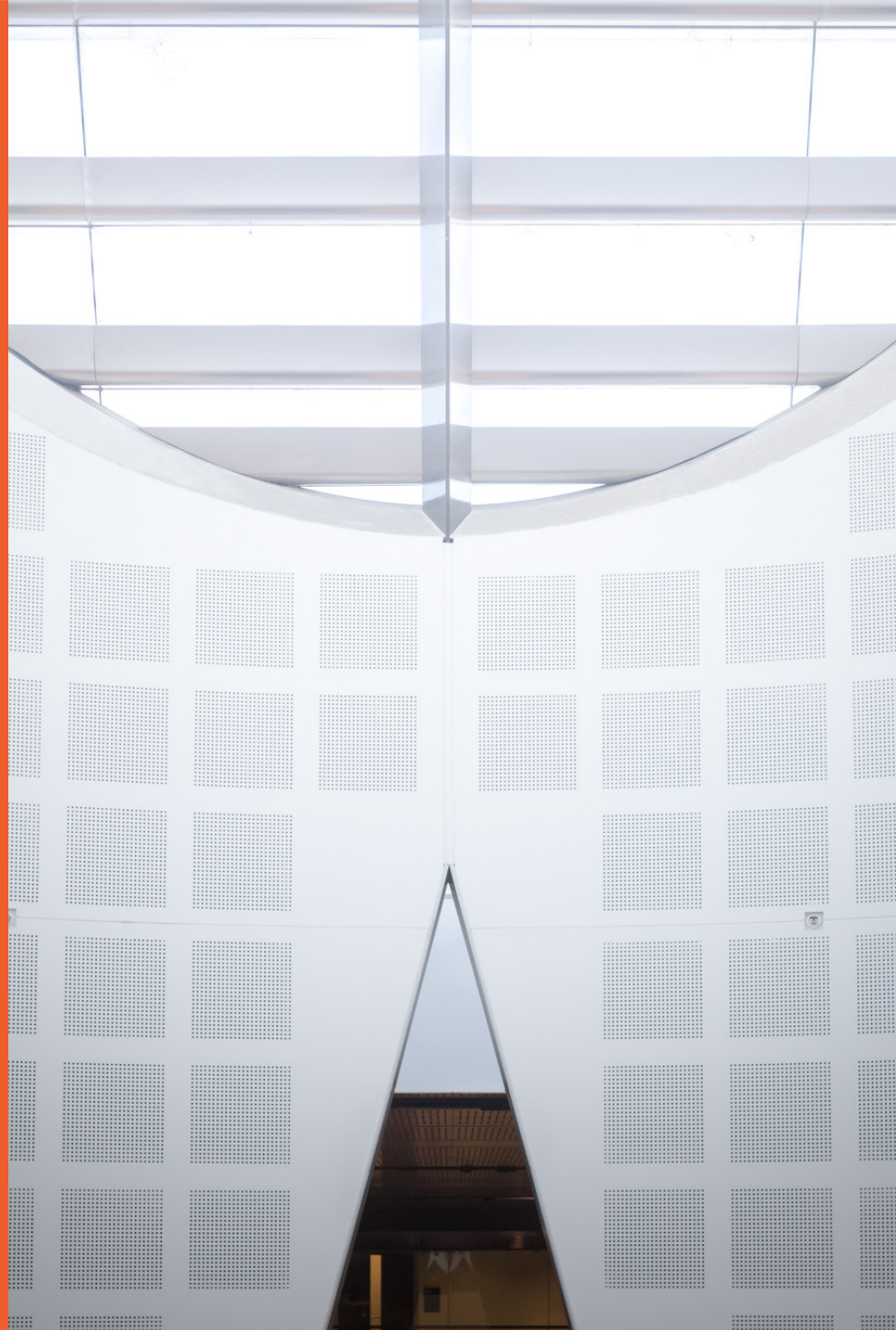


ACCT 6002

International Auditing



THE UNIVERSITY OF
SYDNEY



International Auditing

- **Text readings:**
- *Comparative International Accounting*: Chapter 19
- **Academic paper, on Canvas:** Malsch, B. and Gendron, Y. (2011) 'Reining in auditors: On the dynamics of power surrounding an "innovation" in the regulatory space', *Accounting, Organizations and Society*, Vol. 36, No. 7, pp. 456-76.
- **Self-Study Questions:** See Canvas for instructions

Learning objectives

After this week's studies, you should be able to:

- explain why and how auditing has been internationalized, with particular reference to the role of MNEs, international capital markets, and international accounting firms
- explain why and how the IAASB has become the principal setter of International Standards on Auditing
- discuss the role of ethics, technical standards and quality control in international auditing
- explain the stages involved in the international audit process

- <https://www.youtube.com/watch?v=6wA7ftPndWo>
 - Discussing Andersen's failures
- <https://www.youtube.com/watch?v=LrUbgKGg32Y>
 - Andersen's refusal to testify

Outline

- Overview of external auditing
- Auditing becomes international
- International Standards on Auditing
- International audit processes

Overview of auditing: origins

- “audit” is Latin for “he hears”
- the owner of resources (e.g. the king or the shareholders) listen to an account of what the stewards/managers have done with the resources
- industrial revolution —→ economies of scale —→ large companies
large capital raising —→ many owners —→ agency problem —→
- the industrial revolution happened in the UK, so it has the oldest accountancy bodies, and was the origin of all the big-4 audit firms

Age and size of some accountancy bodies (early 2018)

Country	Body	Founding date*	Approx. members 2018 (000s)
Australia	CPA Australia	1952 (1886)	164
	Chartered Accountants Australia and New Zealand	2014 (1885)	117
Brazil	Conselho Federal de Contabilidade	1946	348
Canada	Chartered Professional Accountants Canada	2013 (1880)	210
China	Chinese Institute of Certified Public Accountants	1988	237
France	Ordre des Experts Comptables	1942	19**
Germany	Institut der Wirtschaftsprüfer	1932	12
India	Institute of Chartered Accountants of India	1949	270
Japan	Japanese Institute of Certified Public Accountants	1948 (1927)	29‡
Netherlands	Koninklijk Nederlandse Beroepsorganisatie van Accountants	2013 (1895)	21
United Kingdom and Ireland	Institute of Chartered Accountants in England and Wales	1880 (1870)	149
	Institute of Chartered Accountants of Scotland	1951 (1854)	22
	Association of Chartered Certified Accountants	1939 (1891)	208
	Institute of Chartered Accountants in Ireland	1888	27
United States	American Institute of Certified Public Accountants	1887	431

*Dates of earliest predecessor bodies in brackets. The names of some of the bodies have changed from time to time.

**These numbers relate to 2011.

‡Excluding junior CPAs.

Overview of auditing: definitions

- AAA defined auditing in 1973 as:
- “a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and **communicating the results to interested users**”
- Auditing is a systematic process, involving these steps:
 - Acceptance and defining the terms of engagement
 - Planning and risk assessment
 - Gathering evidence
 - Reporting

Who performs the audit

- Public accountants (auditors) are those who independently perform audits of financial statements
- They express an opinion on whether those statements are fairly presented (true and fair) in accordance with financial reporting requirements
- External auditors are appointed by companies or their shareholders
- The functions of external auditors vary from country to country:
 - For example, in the UK and Australia the audit report is included in the financial statements to indicate whether they are “true and fair” for shareholders
 - But in Germany, audit was historically focused on legal acceptability (e.g. for creditors and tax calculations), rather than for shareholders

Internationalisation

- Concerned with:
 - 1. The harmonisation of auditing standards and rules
 - 2. Auditing of financial statements prepared by a multinational company, based on one or more sets of auditing rules
- Historically, auditor's work emerged within a domestic context, and they developed approaches that suited the needs of their society
- The users of audits have been constructed differently around the world:
 - Shareholders?
 - Investors?
 - Management?
 - Others?
- Internationalisation of audit started when MNEs began preparing consolidated financial statements

Audit's role

- It is important to remember that the audit function is a critical element in the enforcement of a system of financial reporting
- This is critical to IFRS and the confidence users in the reports being produced

Overview of auditing: process

- The law requires companies to prepare annual reports and to appoint auditors
- Auditors need to be expert and independent

Country differences?

- Age and size of accountancy/audit bodies
- In US, UK, Australia, these bodies were originally in charge of accounting standards as well as audit
- In Germany, France, etc. auditing was about legal acceptability not an opinion on fair presentation

Age and size of some accountancy bodies (early 2018)

Country	Body	Founding date*	Approx. members 2018 (000s)
Australia	CPA Australia	1952 (1886)	164
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Why did auditing become international?

1. Multinational enterprises
2. International capital markets
3. International audit firms

1. Multinational enterprises

- Emergence of MNEs prompted need for internationalized audit
- MNEs grew after 1940s
 - MNEs: Consolidated statements audited to requirements of home country (head office)
 - MNEs: foreign operations audited for consolidated reports; plus there may be local requirements to audit separate financial statements of the foreign operations.
- Large MNEs need to be balanced by large auditors
- Audit firms spread to service their clients in all areas they operate
 - so, Toyota is likely to be serviced internationally by PWC
 - Audit fees then negotiated around large global contracts

Merchandise exports as a percentage of gross domestic product, 1950–98

	1950	1973	1998
France	7.7	15.2	28.7
Germany	6.2	23.8	38.9
Netherlands	12.2	40.7	61.2
United Kingdom	11.3	14.0	25.0
Spain	3.0	5.0	23.5
United States	3.0	4.9	10.1
Mexico	3.0	1.9	10.7
Brazil	3.9	2.5	5.4
China	2.6	1.5	4.9
India	2.9	2.0	2.4
Japan	2.2	7.7	13.4
World	5.5	10.5	17.2

World's top ten non-financial MNEs ranked by foreign assets, 2013

Company	Country	Industry	Foreign assets (US \$bn)	% that is foreign			
				Assets	Sales	Employees	TNI
General Electric	US	Electrical	331	50	52	44	49
Shell	UK	Oil	302	84	61	73	73
Toyota Motor	Japan	Motors	274	68	67	41	57
Exxon Mobil	US	Oil	231	67	67	60	63
Total	France	Oil	227	95	77	66	80
BP	UK	Oil	202	66	66	77	70
Vodafone	UK	Telecoms	182	90	85	91	89
Volkswagen	Germany	Motors	176	40	81	55	59
Chevron	US	Oil	175	69	58	50	59
Eni	Italy	Oil	141	74	72	67	71

Table 1.4 World's top ten non-financial multinationals ranked by foreign assets, 2018^a

Company	Country	Industry	Foreign assets US\$bn	% that is foreign of:			
				Assets	Sales	Employees	TNI ^b
Royal Dutch Shell	UK	Oil	344	84	67	72	75
Toyota Motor	Japan	Motors	303	64	68	64	66
Total	France	Oil	235	97	78	67	81
BP	UK	Oil	220	80	67	59	68
Volkswagen	Germany	Motors	220	43	81	66	60
Softbank	Japan	Telecoms	215	73	51	73	66
Exxon	US	Oil	204	58	65	58	61
British American Tobacco	UK	Tobacco	189	99	99	86	95
General Electric	US	Electrical	187	49	62	66	59
Chevron	US	Oil	184	72	52	51	60

Table 1.9

Share of the world's top 100 MNEs by revenues, 2018

US		37
Europe:		
Germany	8	
France	6	
UK	3.5	
Italy	3	
Netherlands	2.5	
Spain	<u>1</u>	
EU	24	
Switzerland	<u>2</u>	26
China		21
Brazil		1
Japan		9
Russia		2
South Korea		3
Taiwan		<u>1</u>
		100

Source: Prepared by the authors from *Fortune Global. 500*.

Audit report

- opinion section first: mention the applicable framework; give an unqualified, qualified or adverse opinion
- discussion of going concern
- material uncertainties
- auditors' and managements' responsibilities; expectations gap

Examples of Audit Reports

- Shell
- <https://reports.shell.com/annual-report/2021/consolidated-financial-statements/independent-auditors-report.html?tabc=1e1>
- Exxon (see pages 68-69)
- <https://corporate.exxonmobil.com/-/media/Global/Files/investor-relations/annual-meeting-materials/annual-report-summaries/2021-Annual-Report.pdf>
- Chevron (see pages 56 -57)
- <https://www.chevron.com/-/media/chevron/annual-report/2021/documents/2021-Annual-Report.pdf>
- Total
- https://totalenergies.com/system/files/documents/2022-03/DEU_21_VA.pdf

2. International capital markets

- Foreign investors like assurance
- Stock market regulators (co-ordinated by IOSCO) like standardised auditing and audit reports
- Need for more uniform wording in the reports to facilitate legitimacy of the financial statements across jurisdictions
- This supports effective international communication through audit reports

Foreign company listings on major stock exchanges, January 2011

	Number	% of total listings
London	600	20
New York	520	22
NASDAQ	299	11
Euronext	153	14
Toronto	89	2
Australia	88	4
Germany	79	10
Hong Kong	17	1
Tokyo	12	0
Brazil	8	2
Bombay	0	0
Shanghai	0	0

Table 1.6

Foreign company listings on major stock exchanges, August 2018

Exchange	Number of foreign listings
Vienna	552
New York	502
NASDAQ	419
London	421
Singapore	264
Euronext	161
Hong Kong	146
Luxembourg	139

3. International audit firms (I)

- Internationalization of audit has largely taken place within large audit firms
- Large mergers in 1980 and 1990s
- Big 8 → Big 6 → Big 5 → Big 4
- Collapse of Arthur Andersen (after Enron disaster of 2001) led to only four big firms

Growth and mergers of large audit firms (revenues in US \$bn)

	1992	2000	2010	2018
Arthur Andersen	5.6	8.4	-	-
Deloitte (formerly Deloitte Haskins & Sells and Touche Ross)	4.8	12.5	26.6	43.2
EY (Ernst & Young, formerly Arthur Young and Ernst & Whinney)	5.7	9.2	21.6	34.8
KPMG (formerly Peat Marwick and Klynveld Main Goerdeler)	6.2	13.5	20.6	29.0
PwC (PricewaterhouseCoopers, formerly Coopers & Lybrand and Price Waterhouse)	9.1	19.6	26.6	41.3

Audit market share of top 100 companies, 2013

	% of audits	% of fees
PwC	35	43
EY	28	19
Deloitte	22	23
KPMG	14	15
Others	1	0

International audit firms (II)

- Large mergers in 1980 and 1990s
- Big 8 \longrightarrow Big 6 \longrightarrow Big 5 \longrightarrow Big 4
- Collapse of Arthur Andersen (after Enron of 2001) led to only four big firms
- There are about 30 international networks of audit firms
- Big firms each have a global methodology and quality control
- Audit can be uniform even when accounting is not
- This means that:
 1. Multinationals' clients are assured that all members of the audit network apply same approach around the world
 2. Consistency in audit quality across the world, increasing efficiency and effectiveness of the audit process

Table 1.10

Leading international accountancy firms, 2020

Firm	Main countries of origin
Deloitte	UK, US, Canada, Japan
EY (Ernst & Young)	US, UK
KPMG	Netherlands, UK, US, Germany
PwC (PricewaterhouseCoopers)	UK, US

Note: The names given above are those of the international firms. National firms may have different names

International standards on auditing

- International Standards on Audit (ISAs) standard setters:
 - International Federation of Accountants (IFAC):
 - Founded in 1977
 - Not for profit, non-governmental, ‘non political’ organisation of accounting bodies
 - 150 accountancy bodies in more than 100 countries are members
 - Council made up of 1 representative from each body
 - Board made up of 22 members
 - The International Auditing and Assurance Standards Board (IAASB) founded 2002 (succeeded International Auditing Practices Committee) to develop standards for auditing and reporting practices (ISA’s)
 - IAASB can issue pronouncements without the approval of the IFAC Board

Table 19.2

International standards on auditing

Subject matter numbers and ISA document title

200–299 General Principles and Responsibilities

- 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
- 210 Agreeing the Terms of Audit Engagements
- 220 Quality Control for an Audit of Financial Statements
- 230 Audit Documentation
- 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- 250 Consideration of Laws and Regulations in an Audit of Financial Statements
- 260 Communication with Those Charged with Governance
- 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

300–499 Risk Assessment and Response to Assessed Risks

- 300 Planning an Audit of Financial Statements
- 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- 320 Materiality in Planning and Performing an Audit
- 330 The Auditor's Responses to Assessed Risks
- 402 Audit Considerations Relating to an Entity Using a Service Organisation
- 450 Evaluation of Misstatements Identified during the Audit

500–599 Audit Evidence

- 500 Audit Evidence
 - 501 Audit Evidence – Specific Considerations for Selected Items
 - 505 External Confirmations
 - 510 Initial Audit Engagements – Opening Balances
 - 520 Analytical Procedures
 - 530 Audit Sampling
 - 540 Auditing Accounting Estimates, including Fair Value Accounting Estimates, and Related Disclosures
 - 550 Related Parties
 - 560 Subsequent Events
 - 570 Going Concern
 - 580 Written Representations
-

Table 19.2

International standards on auditing (Continued)

Subject matter numbers and ISA document title

600–699 Using the Work of Others

- 600 Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors)
- 610 Using the Work of Internal Auditors
- 620 Using the Work of an Auditor’s Expert

700–899 Audit Conclusions and Reporting

- 700 Forming an Opinion and Reporting on Financial Statements
 - 701 Communicating Key Audit Matters in the Independent Auditor’s Report
 - 705 Modifications to the Opinion in the Independent Auditor’s Report
 - 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
 - 710 Comparative Information – Corresponding Figures and Comparative Financial Statements
 - 720 The Auditor’s Responsibilities Relating to Other Information
 - 800 Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
 - 805 Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
 - 810 Engagements to Report on Summary Financial Statements
-

Regions of the world

- ISAs are translated into other languages by regional accounting bodies
 - e.g. Confederation of Asian and Pacific Accountants (CAPA)
- The EU issued the 8th Directive which:
 - Set qualifications for auditors
 - Some instruction on independence, quality management, content of the audit report, and the audit committee
- US Public Company Accounting Oversight Board (PCAOB)
 - Established under Sarbanes-Oxley Act of 2002
 - Monitors accounting firms; can inspect audits of the audit firms without notice
 - Report on audit quality to the SEC

- [http://www.ey.com/Publication/vwLUAssets/EY-overview-enhancing-the-auditors-report/\\$FILE/EY-overview-enhancing-the-auditors-report.pdf](http://www.ey.com/Publication/vwLUAssets/EY-overview-enhancing-the-auditors-report/$FILE/EY-overview-enhancing-the-auditors-report.pdf)
- Outlines various approaches around the world
- “However, investors have said repeatedly — and we agree — **that it would be much better if the IAASB, the EU and the PCAOB** were more closely aligned. While we recognize that legal, regulatory and reporting frameworks vary, comparability is important for global investors and global markets, and the auditor’s report should be as consistent as possible across jurisdictions.” EY
- Also see https://www.iaasb.org/system/files/publications/files/IAASB-Auditor-Reporting-Comparison-between-IAASB-Standards-and-PCAOB-Rep proposal_0.pdf

Types of work by auditors

- Insolvency, tax, consultancy
- Audit-type work has various levels of assurance

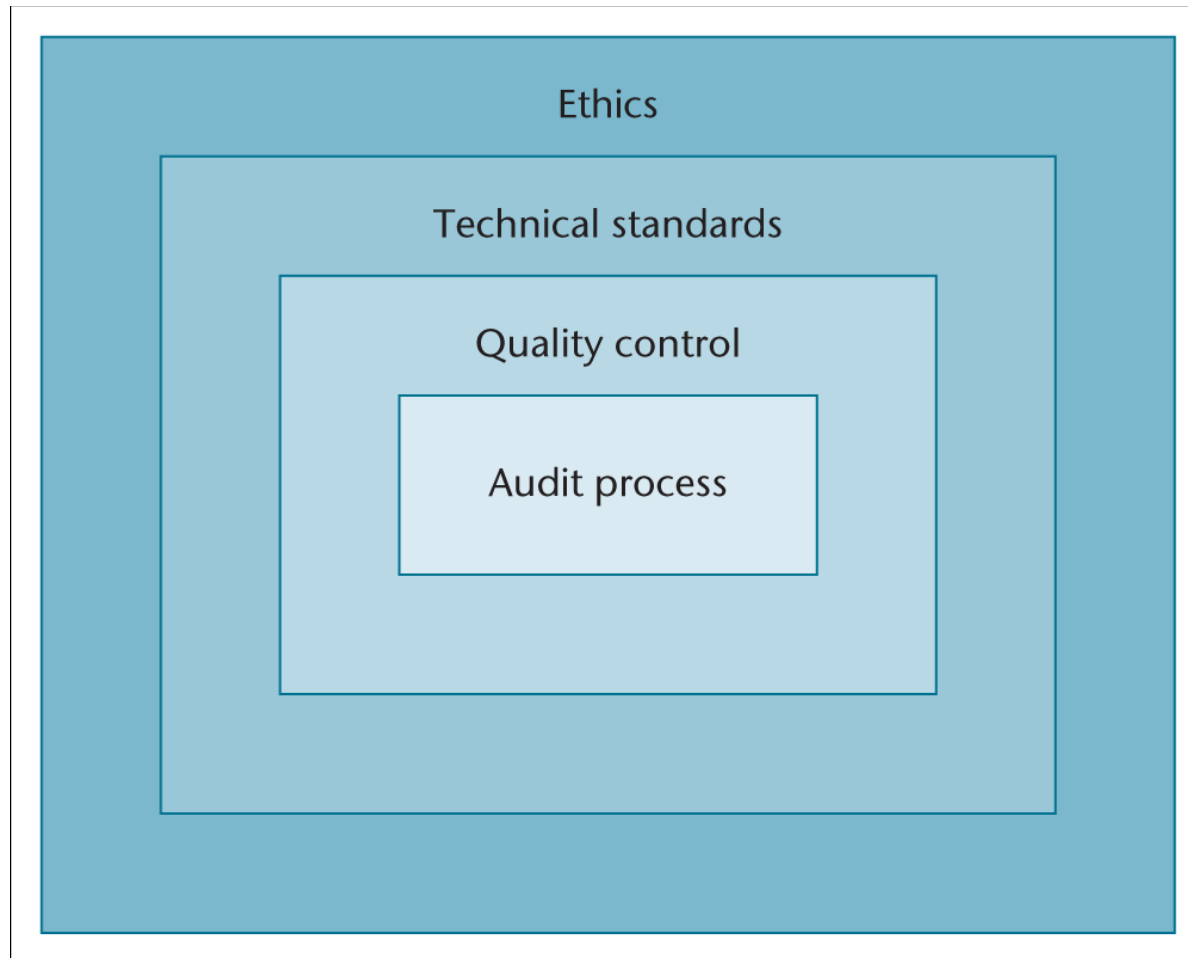
Figure 19.2

Services by auditors

	Assurance services		Related services	
Nature of service	Audit	Review	Agreed-upon procedures	Compilation
Comparative level of assurance provided by the auditor on assertions	Reasonable, but not absolute, assurance	Limited assurance	No assurance	No assurance
Report provided	Positive assurance on assertion(s)	Negative assurance on assertion(s)	Factual findings of procedures	Identification of information compiled

Figure 19.1

The environment of the audit



IFAC code of ethics

- Integrity: straightforward, honest
- Objectivity: avoid bias, conflict of interest
- Competence: care, experience, up-to-date skill
- Confidentiality: no disclosure or use of client information, but this can be overridden by law
- Professional behaviour: compliance with laws; protecting firm and profession

Extra requirement for public practice: Independence

- state of mind (unaffected by influences); and appearance (avoid circumstances that suggest independence is impaired)
- objectivity, professional scepticism
- second review partners
- rotating engagement partners
- avoid: financial involvement with client, managerial appointments (before, during or after), non-assurance services, personal relations

Audit process (I)

- Terms of engagement:
 - defined in detail
 - agreed by more than one partner
 - check the managers and owners of a client
- Planning, risk assessment
 - know the business
 - check the internal controls
 - decide on level of materiality and any specific risks
 - inherent risk, control risk and detection risk
 - nature, timing and extent of procedures
 - coordination, supervision of staff
 - review

Audit process (II)

- Gathering evidence:
 - inspection of documents and assets
 - observation of controls, including internal audit
 - enquiries, including representations from management
 - checking calculations
 - analytical procedures (e.g. ratios, trends)
- Reporting:
 - does all the above lead to acceptable risk?
 - review the financial statements for compliance and fairness
 - normally, now, deal with the client's Audit Committee

Malsch and Gendron

- Suggest that the independence of audit regulators is questionable
- Regulators are too closely allied to firms
- Watchdog function is not operating as it should even after the Enron/Andersen crisis
- The staff of the regulators need to be experienced auditors, so they are often recruited from the big firms – thereby undermining independence and filling the regulatory space with Big-4 views

Additional audit-related youtube clips

- <https://www.youtube.com/watch?v=4aP75PNbwmo>
 - Recent KPMG Scandal
- <https://www.youtube.com/watch?v=G8RqguCAoG4>
 - Arthur Andersen Story