Auditing standards: objectives and importance

Introduction

The regulatory environment makes it mandatory that organizations such as limited liability companies must be audited by an independent external auditor qualified under the regulations of professional bodies internationally or nationally to ensure that the company is working in accordance to the company law set by respective countries. An external auditor functions as an independent body appointed by and reports to shareholders to express an opinion whether the financial statements are prepared, in all material respects, true and fair and in accordance to the applicable financial reporting framework (Pflugrath G., Martinov-Bennie N. and Chen L., 2007). In reporting to the shareholders, the auditor provides reasonable assurance whereby they do not guarantee financial statements are free from material misstatements but rather at an acceptable level. Professional bodies worldwide carries a duty to set auditing standards to play a role of assisting auditors in performing duties in order to provide high level of confidence to intended users of the Financial Statements (Noreen, 1988; Siegel et al., 1995; Wotruba et al., 2001).

Main Report

Development of auditing standards

There are three regulatory environments which govern statutory audits and one of them is auditing standards. At International level, the International Federation of Accountants (IFAC) is the global organization for the accounting profession. An independent standard-setting board under IFAC is known as the International Auditing and Assurance Standards Board (IAASB). The IAASB developed the International Standards on Auditing (ISAs) to be carried out on audit engagements. As for National level, regulations differ as there are various standard setting bodies which choose to adopt the ISAs by modifying it or to set their own standards to suit according to individual countries. In Malaysia, the Malaysian Institute of Accountants (MIA), a member of IFAC is responsible in developing the Malaysian Approved Standards on Auditing (AI) which adopts the modified ISAs. However, the latest development states the implementation of a new board which is the Audit and Assurance Standard Board (AASB) (Cosserat and Rodda, 2009).

Importance of the auditing standards.

An auditing standard is a form of the current best practice applicable in statutory audit engagements by approved auditors which sets a minimum level of technical proficiency to assure work done is of high quality auditing and at the same time providing high level of assurance (Jubb and Houghton, 2007; Simnett, 2007). It is a form of benchmarking the intensity of achieving objectives of the professional bodies in being a role model in the accounting profession as stated by Watkins et al. (2004), and also safeguarding the position of auditors whilst auditing financial statements.

Through professional and ethical standards such as independency and integrity, Alfredson, K. et al. (2005) states that auditors carry out detailed works to value a subject matter whether it is of true and fair view. Once a conclusion is made, the opinion obtained would determine the level of confidence the public would have towards the financial statements (Alfredson, K. et al., 2005).

This adds on to reducing the risk factor faced by users of the financial statements (Martinov, 2004) as it deters directors of an entity to carry out fraudulent activities. At the same time, it also indirectly strengthens the audit profession as the public would have an increased confidence level leading to a better impression towards auditors in general (Simnett, 2007; Dellaportas, Senarath Yapa and Sivanantham, 2008).

As procedures of performing a statutory audit is consistent and of principles-based, it becomes less rigid and flexible to be implemented on the audit works carried out on financial statements. Aside from that, as agreed by Noreen, 1988; Siegel et al., 1995; Wotruba et al. (2001); it may be able to reduce time factor as auditors are able to plan and analyze which area are crucial to be tested more and vice versa because they are already well-versed with the audit procedures set by the standards.

Nevertheless, this may pose as a threat because the use of their own judgement becomes too subjective and thus, they may tend to be too lenient during audit procedures and bypass on important matters. Auditors could even intentionally choose not to perform so much detailed work and just state financial statements as true and fair since knowingly for the past history, it has been stated as so (Jones et al., 2003; Herron and Gilbertson, 2004).

From this matter, it can be of advantage to directors to conduct fraudulent activities because auditors can only consider an opinion on fraud but not able to detect and prevent it. It is the duty of the management and directors to attend to fraudulent possibilities in a company. With that said, they may opt to not comply intentionally by refusing to disclose grey areas in its financial statements or relevant information needed to perform the audit (Cosserat and Rodda, 2009).

While stating to be able to achieve high quality audits worldwide, a handful of countries still implement their own auditing standards to suit their national legislations and traditions (Samuels and Piper, 1985; Tarca, 1998; cited in Dellaportas, Senarath Yapa and Sivanantham, 2008). This is probably due to the fact that there are still many underdeveloped countries which do not have professional bodies for such a purpose as this or even countries like in the United States of America whereby they adopt a different standard which is of rule-based (Simnett, 2007). All this may inversely cause a delay and obstruction to harmonization of standards across the globe in conjunction to international convergence (Weetman, 2006).

Aside from that, consistent updating and revision of standards poses a need to keep oneself updated leading to a lack of confidence while performing duties due to inaccurate execution of standards implied on audit work as there are limitations to how much one can do at a period of time . Being too technical with regulations may cause auditors to be ‘ stiff’ in their performance and thus, lack appreciation on findings of samples, test objects and the assessment of analytical procedures.

Objectives and Activities of IAASB and AASB

Work done by the IAASB is monitored by the oversight body known as the Public Interest Oversight Board (PIOB) whereby the public’s interest is involved regarding proper disclosures and transparency of issues that concerns to improving the overall mission and to achieve objectives of the professional body (Dellaportas, Senarath Yapa and Sivanantham, 2008).

IAASB came up with a development of a program in the year 2004, which functions to redraft the entire ISAs either partially to alter areas in the ISAs or to fully inflict new clarity conventions where applicable. The Clarity Project reached a level of completion upon verification by the PIOB and now contributes thirty-six newly clarified standards as guidelines in assurance engagement by qualified auditors worldwide (Accountants Today, June 2009).

Judging from the fact that the standards now clearly identifies the objectives and obligations an auditor faces, a better understanding of the entire concept and public awareness are gained (Buchanan, F. R., 2003). The newly improved standards are by-far less technical and thus, easily to be adopted by practitioners to be implemented on procedures carried out for assurance engagement.

The whole purpose of conducting the clarity project is to make the standards more appropriate and updated with the recent environment and at the same time to assist and update users of relevant information and a clearer view of utilizing each standard for the benefit of the public (Dellaportas, Senarath Yapa and Sivanantham, 2008). The confidence of the public in financial reporting activities would eventually be increased (Alfredson, K., Leo, K., Picker, R., Pacter, P. and Radford, J., 2005).

It is in a way a good thing to constantly upgrade and redraft the standards to suit the current reporting environment (Humphrey, C. and Turley, S., 2006).

However, there may be a slight disadvantage in the sense of making the revised standards known to its users. The professional bodies would need to conduct seminars or post notices to all members of the professional bodies to inform them of such amendments that has taken place. This eventually takes time and efforts and may even incur a slight cost to be carried out.

Likewise the IAASB, the AASB plays a similar role in upholding an acceptable level of quality professional services and high ethical behaviour amongst practitioners. The MIA further justified the desire of standing-out in the standard-setting process hoping that Malaysian market can be integrated internationally so that viewpoints can be mentioned earlier instead of getting secondhand attention in order to evolve standards that are more suitable to the nature of the Malaysian market (Izma N., 2009).

Implementing the ISAs by the AASB is a form of making efforts to enhance the financial markets of Malaysia in becoming more competitive and stable. At the same time, it also improves professional integrity and quality of audit works by auditors. Under the patronage of the MIA, AASB will continue to meet stringent expectations of stakeholders as well as moving towards a holistic international convergence of standards and enhance confidence of users through proper guidance in audit and assurance services.

This may prove to be a good step ahead in conjunction to be inline with the harmonization of standards in the world today and also to groom the financial position of the country in order to boost confidence of the public once again (Chan and Leung, 2006). Thus, compliance with auditing standards such as the ISAs and enforcing it into objectives and responsibilities stated by the professional bodies need to be acted out quickly so as to not fall behind in time because it can be quite a lengthy process which is not achievable overnight (Izma N., 2009).

Further Regulations

Codes of Corporate Governance

Corporate governance is the system whereby companies are directed and controlled. Cosserat and Rodda, 2009 mentioned that it is useful in avoiding matters such as conflicts of interest seen in the agency theory between the managers (agents) and the shareholders (principal). In accordance to the UK Combined Codes of best practices, the board of an entity is encouraged to form an audit committee to guard the independence and objectivity of auditors.

An audit committee plays a role as an independent point of reference to turn to regarding issues of conflict between the board of directors and the external auditors. Aside from that, in order to improve external audit procedures, they have a duty to monitor the integrity of directors in preparing financial statements.

Codes of Ethics

The onus is always on the auditor not only to be ethical but also to be seen as ethical. The International Ethics Standards Board for Accountants (IESBA) establishes a conceptual framework for all practitioners to adhere to five rules: integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Threats to these principles are to be identified and applied with respective safeguards to mitigate it.

Auditors are subjected to ethical requirements by professional bodies because the public relies on auditors to produce an independent opinion during assurance engagements (Pflugrath G., Martinov-Bennie N. and Chen L., 2007). They further elaborated that a high quality audit, comprising of professional competence and due care characteristics need to be conducted as auditors have access to confidential information of the entity.

Company Law

An auditor is required to perform an annual audit abiding by statutory duties to report to shareholders on whether financial statements are of a true and fair view and in accordance to approved standards. They need to be independent and diligent and state if sufficient information has been obtained and that the company has kept proper records according to the law. The auditor must also list out deficiencies of their findings in the auditor’s report. The company law also determines the rights, appointment, removal and resignation of auditors and the liability of auditors to shareholders and third parties (Cosserat and Rodda, 2009).

Conclusion

The outcome of these findings discussed has added knowledge to a better understanding of the entire audit and assurance cycle. The duties of an external auditor must be based on appropriate conceptual frameworks developed either internationally or nationally according to the suitability of respective countries. They need to perform a statutory engagement required by the company law, which is of high but not absolute assurance that the financial statements are free from material misstatements. An overview of the establishment of auditing standards, its objectives and importance to benchmark the quality of auditors in performing duties and corporate governance, company law and ethical codes as additional regulations in enhancing the role of auditors were identified. Furthermore, the main idea of distinguishing IAASB and AASB on its functions and activities in the world today has added knowledge to the depths of ones' mind. Thus, the respective standards-setting boards need to further enhance and strengthen its actions and procedures in order to achieve international convergence and quality standards to serve the public better and increase in its objectivity effectiveness.