ACCA

ACCOUNTANTS FOR BUSINESS

# Enhancing sustainability and competitiveness: the role of auditing in the Caribbean

## ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 154,000 members and 432,000 students throughout their careers, providing services through a network of 83 offices and centres. Our global infrastructure means that exams and support are delivered, and reputation and influence developed, at a local level, directly benefiting stakeholders wherever they are based, or plan to move to, in pursuit of new career opportunities. Our focus is on professional values, ethics, and governance, and we deliver value-added services through our global accountancy partnerships, working closely with multinational and small entities to promote global standards and support.

We use our expertise and experience to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest.

Our reputation is grounded in over 100 years of providing world-class accounting and finance qualifications. We champion opportunity, diversity and integrity, and our long traditions are complemented by modern thinking, backed by a diverse, global membership. By promoting our global standards, and supporting our members wherever they work, we aim to meet the current and future needs of international business.

## ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, *Accountants for Business*, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

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In April 2012, *ACCA Caribbean* held a series of three events in Barbados, Trinidad and Jamaica to assess the role and future of audit. The events, attended by government representatives as well as private sector accountants, mirrored round tables ACCA has previously organised in many other regions, as part of its involvement in the global audit debate.

# Introduction

The three events, held by ACCA in conjunction with the national accountancy bodies of Barbados, Trinidad and Jamaica, were entitled: 'The critical role of auditing in enhancing sustainability and competitiveness'.

The title sums up ACCA's view, expressed repeatedly over the past three years, that audit has a crucial role to play in boosting and maintaining trust in financial statements, and hence in wider business performance. ACCA has argued that audit is not 'broken' – but that its value to investors and other users could be enhanced if the role were broadened to take in a wider range of activities than just the historic financial statements. President Dean Westcott develops this argument below and gives an assessment of other topical issues in the current debate.

Many of the points were echoed by other speakers at the three events – who consisted mostly of auditors from the Big Four firms and government departments. It is clear that there is a general acceptance that the status quo is not an option: the profession is persuaded of the need for change and evolution of the audit function. It is essential that it does so – for a lack of positive engagement leaves the profession vulnerable to having undesirable proposals forced upon it. In fact, the responses given by speakers gives cause for optimism that auditors will rise to the challenge set by regulators when the latter finish their deliberations and spell out the new agenda.

Several points, including those set out below, came up at more than one event.

- Independence – this is regarded as crucial, but the proposal for mandatory rotation of auditors (by both the European Commission (EC) and PCAOB, the US regulator) is not supported. This is regarded as a 'solution looking for a problem'. There is no evidence that it increases audit quality, which should be the focus of the debate.

- Options for increasing auditor scope could include items such as a review of corporate governance systems, risk-management policies and more details on accounting and auditing policies.

- The adoption of best practices in corporate governance is essential and is most likely to be achieved by well-resourced internal audit functions reporting to audit committees comprising independent directors.

- It can be expected that liaison between auditors and regulators will increase – but regulators must be respectful of client confidentiality when making requests, and must develop their own mechanisms for gaining the information they need, rather than depending on auditors' reports.

It is particularly pleasing that three such high-quality events were held in the Caribbean, as this is not a region that had featured in ACCA's previous global audit roundtable series in 2010. ACCA will certainly be incorporating the information and findings of these events to inform its own audit policy positions, as the international debate on the future of audit evolves.

# ACCA's views

**Dean Westcott, ACCA president, set the scene for other speakers at all three events by spelling out ACCA's own views on the future development of audit and key issues in the debate, as follows.**

The global debate over the future of audit has now been raging for three years and ACCA has taken an active role in that time. We have held a large number of round-table events around the world, carried out various research projects and written several policy papers. It is one of the key topics in our global Research & Insights programme, which we have established to try to find answers to key business problems.

The global financial crisis has caused regulatory authorities across the world to reassess whether the audit function as it is currently framed still adds value to companies and their stakeholders. And this is the subject that is closest to ACCA's heart.

Many have said that the current role is too limited; that it was not the case that auditors had failed to do their jobs during the crisis – rather that the task of verifying backward-looking financial statements was itself too narrow. The starting point for the review of audit by the authorities in the UK, mainland Europe and the US, among others, has been that the time is right to consider whether audit is looking at the right things, and whether audit could become more wide-ranging and forward-looking.

ACCA welcomed that focus on the nature of the audit and in many ways we believe it is a shame that the EC, in particular, has become rather side-tracked away from the issues of value and quality of audit, and has become more interested in structural changes and market concentration.

It is true that research undertaken since the financial crisis broke in 2007 tends to confirm that there remains a high degree of stakeholder satisfaction with what auditors do. The Value of Audit report issued by the respected University of Maastricht (MARC) canvassed the views of CFOs, members of audit committees and market analysts on their views of the effectiveness of audit. On a scale of 1 to 10 (1 = no value and 10 = excellent value), those three stakeholder groups gave audit a score of 7.3. They did, however, suggest that they would like the auditor to cover more ground and review and report on additional issues such as the management of risk.

Similar responses were forthcoming from stakeholders who attended a series of international round tables organised by ACCA in 2010, who said that audit as it stands is valuable, but could usefully develop further. ACCA subsequently proposed that the scope of audit should expand to take on new responsibilities to report on risk, corporate governance and the financial assumptions that underlie the company's business model.

In 2011, ACCA built upon this outreach by commissioning a research project, also by MARC, which analysed further how the approach of extending audit reports could work in practice. One of its suggestions was for a free-form audit report, the Auditor Discussion and Analysis (AD+A), which would mirror the Management Discussion + Analysis narrative report. In June 2011 the US regulator, the Public Company Accounting Oversight Board (PCAOB) also included this idea in its wide-ranging concept release, which put forward various scenarios for audit reporting. This followed outreach with investors and other users of the audit report, the conclusions of which largely echoed those of ACCA's round-table series: that there was a clear gap between what users ideally wanted, and what was currently being offered.

The International Auditing and Assurance Standards Board (IAASB), which sets the International Standards of Auditing (ISAs), engaged in a similarly wide-ranging review of the role of audit: 'Enhancing the Value of Auditor Reporting: Exploring Options for Change'. Like ACCA, the IAASB asked whether the scope could be expanded; it focused on five particular areas for potential extension. These were:

- corporate governance arrangements
- the business model, including the sustainability of the model
- enterprise-wide risk management
- internal controls and financial reporting processes, and
- KPIs.

In short, there is international interest in the question of whether the audit process as currently defined continues to attract stakeholder approval and whether the scope of audit might usefully expand and evolve in order to meet the information needs of investors, lenders and market regulators.

There is also the related issue of auditor communication. Our other contributors will address the question of the communication between auditor and regulator, which is becoming an important issue – certainly it was one of the key findings of the UK House of Lords inquiry into audit, which found that this previously regular communication had declined sharply in recent years and needed to be resurrected. Regulators increasingly see such a link as being integral to the modern role of the auditor.

In ACCA's view, this development needs to be treated carefully, as reporting functions such as these can potentially conflict with auditors' professional duty of confidentiality. The nature of the relationship between auditor and client is in some ways changing: whereas in the past the auditor would owe responsibilities only to the client, and owe professional and legal obligations to keep client information confidential, increasingly, the auditor is being asked to act, in a sense, as an agent of the state.

It should still be seen as being in the public interest for clients to be able to discuss their affairs openly with their auditors – if they do not believe they can do this, one risk (among many) is that audit quality will suffer since auditors will not be in a position to give an audit opinion on the basis of the full possession of relevant information. It is important, therefore, that there is careful balance between cultivating the relationship of confidence between auditor and client and ensuring the efficient communication of significant public interest information to relevant authorities. Maintaining this balance will require mutual understanding.

The effectiveness of the audit, in the case of large companies, can also benefit from establishing privileged channels of communication between the auditor and dedicated company audit committees. In addition, it must be said that in much of the outreach carried out by ACCA and by the regulators in their consultation exercises mentioned above, investors have asked for this communication to be extended to them also. They have asked for auditors to be obliged to raise 'red flags' about looming problems – given that they are effectively paying for the audit, why should they be the last to know about these findings? Increasing communication between auditors/audit committees and the investors is a difficult issue (given the risk of destabilising the company by openly discussing imminent problems) but one that will not go away and that, ACCA believes, the profession needs to address,. Investors' interests need to be at the heart of audit and corporate reporting – that needs to be the starting-point for future developments.

# Event report, Barbados, 16 April 2012

## SPEAKERS

Dean Westcott, ACCA president

Betty Brathwaite, partner, Deloitte; president, Institute of Chartered Accountants of the Caribbean; ACCA International Assembly Representative

Andrew Brathwaite, president, Institute of Chartered Accountants of Barbados

Carol Nicholls, partner, KPMG

Lisa Padmore, partner Ernst & Young

## CONTEXT

The context for the round table, which was attended by more than 60 auditing and accounting professionals from both private and public sectors, was set by ACCA president Dean Westcott (see above).

### Reinforcing the independence of the auditor

Two of the panellists made presentations about reinforcing the independence of auditors.

Betty Brathwaite focused on the question of whether the ethical guidelines for auditors are still sufficient: should they be reinforced by stronger legal controls and, if so, how would this affect the independence of the auditor? She said: 'Auditor independence is essential to maintaining confidence in audit quality and the quality of financial reporting. Independence, objectivity and professional scepticism are the foundation of audit quality and are fundamental to the future of the profession'.

Audit firms, through very stringent independence requirements, mandate auditors in public practice to follow specific ethical guidelines. This can be supported throughout the audit process by ensuring the presence of strengthened audit committees, independent regulatory oversight and internal oversight.

Concern was expressed about some of the proposals for mandatory rotation of auditors. In this regard, Ms Brathwaite listed some of the problems of auditor rotation as, 'loss of auditor knowledge, difficulty in maintaining industry experience, audit costs and fee pressures, displacement of audit committee control, intensified emphasis on marketing'.

Lisa Padmore referred to the high-level international reviews on auditing matters happening in the EU and the US on issues such length of service and the range of services that auditors can provide to their audit clients. A limited number of countries require mandatory rotation and proposals are under consideration in the EU, US and India. Ms Padmore suggested that it has not been proved that mandatory auditor rotation improves audit quality.

Ms Padmore concluded that auditors perform their work in accordance with International Standards on Auditing so if audits are not meeting the requirements of the public then part of the solution must be changes to the standards and not just mandates from public oversight bodies. She said there also needs to be a change in the scope of audits to make them more forward looking – a stance with which ACCA agrees, as Dean Westcott had explained in his address.

### Enhancing and regulating the work of auditors

Andrew Brathwaite took up the theme of whether the nature and scope of audit were still appropriate. Could auditors usefully address new and additional matters, such as giving a view on the client's risk management processes? Could the form of the audit report be made more informative? What is expected from auditors in terms of compliance standards outlined by governments and procedures followed by monitoring bodies?

Emphasising that 'the status quo is not an option', Mr Brathwaite made the observation that, for audit regulation, change was already a reality and that the audit profession has changed from a fully self-regulatory model to one where, at an increasing rate, government bodies are exercising great influence on the profession. The involvement by government has been fuelled by recent concerns about companies that had received unqualified audit reports but then failed a relatively short time later. He referred to the so-called ‘expectations gap’, where the public assumes that audits cover more than they really do at present. Auditors were urged to ensure that they contributed to the process of change so that their experience and expertise could be reflected in the final outcome.

The scope of the audit will change to incorporate some of additional disclosure issues mandated by regulators, said Mr Brathwaite. Nonetheless, a balance must be found between the need to provide more information in financial statements and the need to keep the statements simple and easily readable. The following disclosures would enhance the level of information revealed in the audit report:

- the basis of the auditor’s materiality assessment
- audit risk
- key audit issues and their resolution
- key business and operational risks
- key performance indicators
- the quality and effectiveness of the governance structure
- risk management, and
- internal controls.

There is also the need to reduce the negative perception associated with qualification of audit reports. Greater timeliness in the completion of the audit report would add to its value, he argued. Therefore both the company and the auditor should work towards reducing post-year-end delays, which affect the timeliness of the auditor’s report.

Strengthening the contribution that auditors make to company regulation, Carol Nicholls noted that the public had been alarmed by recent financial failures and that it wanted early-warning mechanisms. This has provided the impetus for regulators to focus increasing attention on the management of companies, their governance and the quality and timeliness of financial reporting. She suggested that the regulator was fast becoming as much a permanent part of public companies’ governance framework as the financial management (including internal audit), board of directors (including the audit committee), and the external auditors.

The solution to the concerns of the public and regulators must include the strengthening of corporate governance. Ms Nicholls highlighted the important roles of the internal and external audit function and noted that the International Standards on Auditing (ISAs) already provided guidance on their role.

It was noted that regulatory needs are not the primary purpose for which financial statements are prepared. Regulators must therefore develop their own appropriate mechanisms, including on-site inspections, rather than depending on auditors’ reports for information. In the future it can be expected that auditors and regulators will collaborate more. Even so, information requests from regulators should be rooted in law and must incorporate respect for the confidentiality of client information.

## PERSPECTIVES FROM PARTICIPANTS

During the period of lively open discussion, the issues raised included the following.

- Internal audit: some companies and government agencies do not demonstrate full commitment to the internal audit function. These departments are under-resourced and sometimes come under pressure from management as they attempt to perform their functions. Concern was also expressed that some external auditors may not be making the fullest use of the work done by the internal auditors.
- Fraud: what is best practice for external auditors when fraud is detected?
- Corporate governance: there is a need to promote best practice, starting with appointing capable individuals to boards of directors.
- Regulatory breaches: is the auditor expected to discover and/or report on such breaches?

## CONCLUSIONS AND THE WAY FORWARD

Maintaining the status quo is not an option. The audit profession in Barbados recognises that change is inevitable and will ensure that it contributes to the debate on the direction and pace of change. The Institute of Chartered Accountants of Barbados (ICAB) will comment on exposure drafts, policy papers, draft legislation and any other reform proposals.

The independence of auditors and strong ethical guidelines are essential for the maintenance of the value of assurance services provided by the auditors.

The arguments for mandatory rotation and audit-only firms are not supported. There is no evidence that these will improve audit quality.

The expectations of the public and the current rules that guide the conduct of audits are out of alignment. Both need to be changed, the first through public education and the second through the accounting and auditing regulators.

The adoption of best practices in corporate governance is essential. These best practices must include the use of fully resourced internal audit departments reporting to audit committees comprising independent directors.

The need for good corporate governance extends to government-owned entities, especially statutory boards. Through its Public Sector Committee, ICAB will collaborate with government to promote improved standards in the public sector.

ICAB will perform its public interest function to ensure the quality of public auditing by providing oversight through the Practice Monitoring Programme.

# Event report, Trinidad, 17 April 2012

## SPEAKERS

Dean Westcott, ACCA president

Brenda Lee Tang, ACCA Caribbean Office

Richard Young, managing director of ScotiaBank Trinidad, head of the T&T Bankers Association (panel chair)

Colin Wharfe, partner, PwC

David Hodges, partner, Deloitte

Chris Hornsby, partner, KPMG

Jennifer Fredericks, representing ICATT

## OVERVIEW

As at the Barbados event, there was discussion of the role of auditors in a changing environment, led by a review of the recent European audit reform proposals. To a large extent, presentation and proposals focused on issues already being addressed in other territories, particularly Europe and North America.

There was general agreement that the audit model is not 'broken'. The majority of stakeholders are satisfied, panellists agreed. It was believed that local, regional and international financial crises would not have been avoided by implementing auditor rotation and other recommendations by the European regulators and others. To a large extent, these were failures of corporate governance, regulatory oversight and political will to intervene.

On audit rotation, the larger audit firm representatives were unanimous in rejecting this as a device that would improve the quality of audits. International research was quoted indicating that restatements did not increase following rotation. The argument was made that regular rotation would also increase costs owing to first-year familiarisation and final-year hand over.

A counter-argument was put by a senior public sector audit official, who suggested that the major risk of non-rotation was over-familiarity of audit staff with client staff. The panellists responded that compliance with ISAs, as issued by the IAASB, and appropriate control structures was sufficient to deal with this. A member of the audience suggested that costs might be reduced in practice by the tendering process.

The discussion then centred on the possible expanded role of auditors, in which the potential areas included:

- increased commentary by auditors on risk management, governance, environmental impact, assumptions underlying the business model, internal controls, financial reporting processes, KPIs, and performance reporting
- greater explanations on audit scope, inclusion of forward-looking information, and
- increased reliance by regulators on auditors and other professionals.

Some concerns were, however, expressed with such proposals. Some members of the panel and audience mentioned:

- unnecessary overlap with areas currently covered by internal audit and/or the audit committee
- the risk that in the financial statements, auditors would be generating information instead of commenting on information produced by management
- the risk that auditors would become de facto extensions of the regulator
- client confidentiality issues
- increased and unnecessary costs
- the need for local institutes to promote the value of an audit and help manage the gap between public expectation and reality.

## THE TRINIDAD MARKET

In an environment where there are relatively few listed companies and public-interest entities, the need for clearer guidance and differential treatment for auditors of SMEs and micro enterprises is pressing.

Lack of knowledge of IFRS/ISAs and best practices remains a significant issue for many practitioners.

There has been a failure of audit committees, in practice, to keep themselves up to date and to exercise real governance.

Information systems are not actually capable of producing the information necessary to meet current IFRS needs – far less the suggested expansions to auditor/management reporting.

There was general agreement on the need for some form of public oversight of listed/public interest entity audits. Local SEC / ICATT / Central Bank are working on developing a mechanism for this.

## SUMMARY OF FINDINGS

### Reinforcing the independence of the auditor

Auditors must be willing to change as responsibilities and reporting evolve.

Global initiatives, which will affect standards and regulation in Trinidad and especially the quality and scope of the audit, are being monitored carefully.

Mandatory audit rotation is a 'solution looking for a problem'.

### Enhancing and regulating the work of auditors

Internal controls are a concern.

There is a gap between the traditional role of the auditor and what is expected by the market/stakeholders. Possible ways of bridging the gap include increasing the scope of the audit and the reporting framework, including a review of corporate governance systems and review of risk-management policies, and provision of more details on the audit methodology.

### Strengthening the contribution that auditors make to company regulation

There are Trinidad-specific issues: the lack of narrative reporting accompanying accounts and lack of availability of financial reports for private companies in Trinidad

There is a need to increase and widen the communication of audit findings: when a company is hitting problems, investors need to know

The impact of regulatory changes on auditors' duty of care and liability needs to be carefully considered.

## DISCUSSION

The Institute of Chartered Accountants of Trinidad and Tobago (ICATT) can play an enhanced role in educating the market about the audit and its scope.

Partners need to be intimately involved in the audit even though juniors may do most of the preparatory work, both so that partners know what they are signing off and to limit liability.

Regulators have an extremely important role to play in ensuring compliance with the regulatory framework by companies but can only do so within the scope of national legislation.

# Event report, Jamaica, 19 April 2012

The Jamaica event was structured in a similar way to those of Barbados and Trinidad.

## SPEAKERS

Leon Andersen – executive director (acting) Financial Services Commission

Pamela Monroe-Ellis – auditor general of Jamaica

Alok Jain – Parner, PwC

Gihan De Meil – partner, Deloitte

Andrew Tom – partner, Ernst & Young

Nigel Chambers – partner, KPMG

## REINFORCING THE INDEPENDENCE OF THE AUDITOR

The need for ethical guidelines was underscored with reference to the risks to which auditors are exposed and the need for protection against those risks. Ethical guidelines can provide that healthy balance. With reference to the International Federation of Accountants (IFAC) Code of Ethics and the Institute of Chartered Accountants of Jamaica (ICAJ) Code of Conduct, it was posited that sufficient guidelines currently exist. In fact, it is the monitoring for compliance that is lacking. In addition, the call was made for serious consideration to be given to the impact on smaller audit firms of complying with these guidelines.

As with the other two events, current development in the US and EU were highlighted and included discussions around:

- audit firms
- mandatory rotation of audit firms (six years on and four years off)
- whether regulators should have veto power in the appointment of auditors
- cap to be placed on fees from other services offered by audit firms
- audit committees
- the composition of these committees and whether they should include more accounting and auditing competencies
- audit reporting
- proposed free-flow reports to allow auditors to opine not only on the financial statements but also on such areas as quality of accounting policies and managements' estimates
- market forces affecting the profession
- the apparent excess of supply versus demand
- the 'trust deficit' resulting from high-profile corporate failures
- improvements in technology
- reduced reliance by the market on financial statements.

## STRENGTHENING THE CONTRIBUTION THAT AUDITORS MAKE TO REGULATION – PUBLIC SECTOR

The discussion was framed in the context of the audit function within the government.

It was observed that there is significant scope for auditors to strengthen the oversight roles within the current structure. It was also noted that the audit function in government should be transformative, bringing greater efficiency and effectiveness to the system. This was a move that the speaker indicated was supported by IFAC at a recent seminar on the sovereign debt crisis. IFAC posited that there is an urgent need for transformation in public financial management.

There are reporting lines that are clearly undesirable and although mitigating controls are in place much more can be done to improve the effectiveness of the audit function.

It was noted that improvements in efficiency and effectiveness must be pursued while still giving due consideration to confidentiality. As part of the strengthening of audit, regulations such as the Protected Disclosure Act are soon to be promulgated; this will allow for information sharing among the various oversight bodies without breach of confidentially.

## STRENGTHENING THE CONTRIBUTION THAT AUDITORS MAKE TO REGULATION – COMPANIES

There are indications that regulators are placing increased responsibilities on auditors and requiring far more than the opinion on the financial statements. Regulatory requirements are increasingly more stringent and far reaching, for instance the requirement that the same auditor be used for all the companies within a group, a determination once left to the discretion of the company (for the most part).

Given the foregoing, increased collaboration between the profession and regulators becomes imperative. Deep consultation on proposed regulations is facilitated via the ICAJ.

## ENHANCING AND REGULATING THE WORK OF AUDITORS

As in Barbados and Trinidad, delegates assessed whether the scope of audit should be expanded. The profession's 'glorious past' was examined. It was noted that that past had served us well. Nonetheless, there is now need to change. The following forces were noted as affecting the profession:

- technology
- competition
- the 'trust deficit'
- increased demand for assurance beyond the financial statements.

Auditors must move beyond the scope of the financial statement audit because a significant portion of company value (market capitalisation) is not reflected on the balance sheet and hence not audited. There are several areas where the information needs of the market are not currently being met, which provide opportunities for the profession. Some of these areas include:

- assurance about the competence and integrity of management
- assurance about risks and risk-management practices
- assurance on financial projections
- 'green' audits and 'social responsibility' audits.

It was concluded that the current scope of audits must indeed change for the profession to remain relevant.

## QUESTIONS RAISED IN Q&A SESSION

- How will small accounting/auditing firms comply with many of the requirements of the code of ethics, for instance partner rotation, to remain independent?
- What is being done to address the concerns of these small practitioners who do not have the same resources at their disposal as the Big Four?
- What is ACCA/ICAJ doing to address the disconnection between the need for the voluminous financial statement and the users of these financial statements, as it appears nobody uses them?
- What is ACCA/ICAJ's view on whether accountants and auditors should perform the role of 'bean-growers' rather than 'bean-counters'?
- What is the FSC's rationale for requiring that the group auditors must audit all subsidiaries?
- Do ACCA/ICAJ/Big Four firms have a document on the structure, composition and operation of the internal audit (IA) function? Is IA addressed by the ICAJ/ACCA?

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