

Chapter 1

Regulatory Environment

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Chapter overview



Technical content



Activity



Answer to activity



Real world example



Exam focus



Model



Resources



Key questions

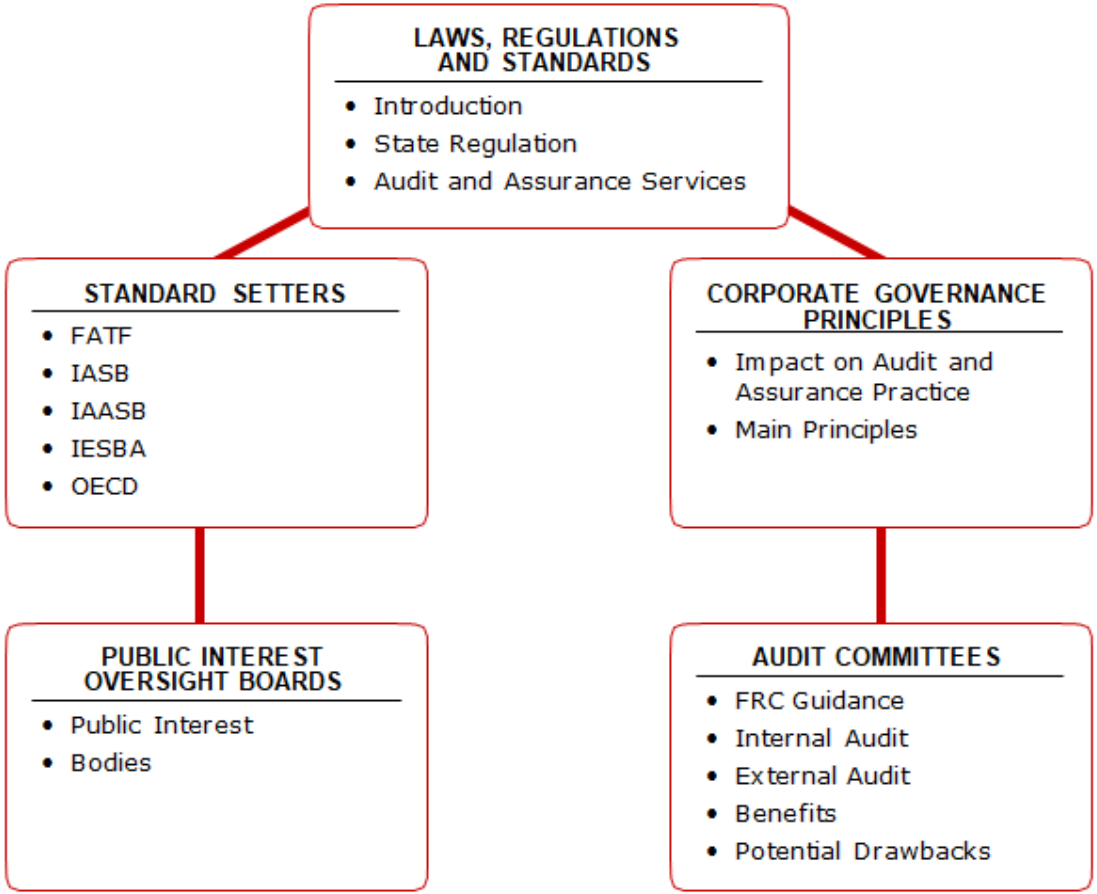


Chapter summary



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CHAPTER 1: Regulatory Environment



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Public Interest

The collective well-being of the community of people and institutions the professional accountant serves

Sources of guidance:



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Examples of Standard Setters

- FATF – the Financial Action Task Force on Money Laundering
- IASB – the International Accounting Standards Board
- IAASB – the International Auditing and Assurance Standards Board
- IESB – the International Ethics Standards Board for Accountants
- IOSCO – the International Organisation of Securities Commissions
- OECD – the Organisation for Economic Cooperation and Development

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ISA 200 *Overall Objectives of the Independent Auditor …*

- Overall objectives
- Defines terms
- Nature and scope of the audit
- Scope, authority and structure of ISAs
- General responsibilities of the independent auditor

Requirements:

- Compliance with ethical requirements and ISAs
- Professional scepticism and professional judgment in planning and performing an audit
- Sufficient appropriate audit evidence be obtained to reduce audit risk to an acceptably low level

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Public Interest Oversight

The profession monitors itself to ensure that the public interest requirement is met.

- IFAC established the PIOB in 2005 (see www.ipiob.org).
- The PIOB oversees IFAC's auditing and assurance, ethics, and education standard-setting activities as well as its Member Body Compliance Program.
- In the US, Public Company Accounting Oversight Board (PCAOB) protect investors and the public interest by promoting informative, fair and independent auditor’s reports.
- In the UK, accountancy practice monitored by Financial Reporting Council (FRC).

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Corporate Governance

The system by which organisations are directed and controlled

Impact on audit and assurance practice

- Published audited financial statements are the main source of information for stakeholders
- Credibility is supported by the auditor's opinion

"Comply or explain" approach

- Based on a set of principles (often a code of best practice)
- Compliance is expected
- Any non-compliance must be disclosed and explained

"Rules-based" approach (e.g. the US)

- Is more prescriptive and required by legislation

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Main Principles of Corporate Governance

- **Board leadership and company purpose** (e.g. company headed by an effective board and communicates well with stakeholders)
- **Division of responsibilities** (e.g. board is not inappropriately dominated by one individual and should be balanced to be effective)
- **Composition, succession and evaluations** (e.g. the board is well composed, answerable to stakeholders and diverse)
- **Audit, risk and internal control** (e.g. the board actively manages the business and controls it)
- **Remuneration** (e.g. designed to support strategy and long term success)

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Audit Committees

- All members must be independent non-executive directors
- All members should be competent
- At least one member should have recent and relevant financial experience



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Audit Committee: Remit

1. To monitor the integrity of the financial statements and review significant financial reporting judgments contained in them.
2. To advise the board on whether the annual report is fair, balanced and understandable and provides the information necessary for users to assess the company's performance, business model and strategy.
3. To review the company's internal financial controls, internal control and risk management systems (if no specific risk committee).
4. To monitor and review the effectiveness of the internal audit function. If there is no internal audit, to consider annually the need for internal audit and make that recommendation to the board.
5. To recommend, for approval in general meeting, the appointment, re-appointment, removal and remuneration of the external auditor.
6. To review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process.
7. To develop and implement policy on the engagement of the external auditor to supply non-audit services.
8. To review "whistle-blowing" arrangements by which employees may, in confidence, raise concerns about possible improprieties in financial reporting and ensure independent investigation and appropriate follow-up action.

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Audit Committee: Interaction with External Auditors

The audit committee should be involved at all stages of the audit.

The committee obtain assurance that a quality audit will be performed and assess the effectiveness of the audit.

- Was the audit plan met? Or were changes understood?
- Were the auditors robust and perceptive?
- If the auditor resigns, the committee considers why and takes any necessary action

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Audit Committee: Benefits and Drawbacks

Benefits

- Effective oversight
- Enhances confidence in financial information
- Independent judgements of NEDS critical to business
- Point of contact for internal and external auditors

Potential drawbacks

- An unnecessary regulatory burden?
- Added cost
- Responsibility on committee too high
- May be ineffective if unable to act according to corporate governance recommendations

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Exam focus

Key advice in for all AAA questions is '*Read the requirement carefully*'.

Below is an extract from an examiner's report relating to a corporate governance requirement in 2016:

The second element related to implications of the governance structure and a potential listing may have on the audit process.

Many candidates appeared to interpret this as a requirement to comment on how the governance structure of the client fell below best practice and **did not address the audit implications at all**.

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Real world example: Corporate Governance Report

Many companies publish details about their corporate governance arrangements on their websites.

Reading these reports helps to bring corporate governance arrangements to life.

Here is an example:

Link to example

Sanlam Governance Report



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Activity

Three committees required by corporate governance codes are shown below.

Nomination

Remuneration

Audit

Match each committee with the weakness below most likely to impact their area of responsibility.

Insufficient financial understanding at board level

Board members focussing excessively on short-term profitability

Lack of effective independent non executive directors

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Answer to Activity

Insufficient financial understanding at board level	Nomination
Board members focussing excessively on short-term profitability	Remuneration
Lack of effective independent non executive directors	Audit

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Technical article

Click the link below to open the article on accaglobal
Technical article **Corporate governance and its impact on audit practice**

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Chapter 1: Summary

- *Public interest* refers to the collective well-being of the community of people and institutions the professional accountant serves.
- Corporate governance is the system by which organisations are directed and controlled.
- Published audited financial statements and related information usually provide the main source of information that shareholders and other stakeholders have access to.
- There are two main approached to corporate governance: “comply or explain” or a more prescriptive rules-based approach.
- The audit committee has many roles and responsibilities relating to the:
  - Integrity of the financial statements and the information provided in the annual report
  - Effectiveness of internal financial controls and risk management systems
  - Effectiveness of the internal audit function
  - Appointment of the external auditor
  - External auditor's independence and objectivity
  - Effectiveness of the audit process

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Chapter 1: Practice question

Study Question Bank	
Audit committee	40 mins *
* includes time for tutor guidance	

For AAA

- **Attempt the Study Question Bank question listed above after studying this chapter**
- **Attempt Revision Question Bank questions in your revision phase, after studying all chapters**

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Thank you

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