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Item 3 of the provisional agenda

### Review of practical implementation issues relating to international financial reporting standards

## Practical challenges and related considerations in implementing international standards on auditing

Note by the UNCTAD secretariat\*\*

### *Executive summary*

This note provides an overview of the institutional aspects of international standards on auditing (ISAs) that are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). It discusses the roles of IFAC and IAASB. It also discusses IAASB's Clarity Project. The paper notes that more than 100 countries or jurisdictions use auditing standards that are ISAs – either adopted as written by the IAASB or with essential jurisdictional changes – or national auditing standards that are compared to ISAs to eliminate differences. This note elaborates on the following considerations for addressing practical challenges that arise in the implementation of ISAs: (a) a robust implementation strategy and action plan; (b) adequate implementation support infrastructure; and (c) training, education, and timely and high quality translations of ISAs.

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\* ISAR documents were previously issued under the symbol TD/B/COM.2/ISAR/...

\*\* This note was prepared with substantive input from the staff of the International Auditing and Assurance Board (IAASB) of the International Federation of Accountants (IFAC).

## I. Background

1. In view of the widespread adoption of international financial reporting standards (IFRS) in recent years, UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been reviewing practical issues that arise in the course of implementing IFRS, with a view to facilitating the sharing of experiences and lessons learned among member States. At its twenty-second session, ISAR deliberated on a background note (TD/B/COM.2/ISAR/28) prepared by the UNCTAD secretariat which highlighted major practical implementation issues pertaining to institutional and regulatory arrangements, enforcement mechanisms, technical issues and capacity-building. On the basis of this framework, country case studies covering Brazil, Germany, India, Jamaica and Kenya were prepared and considered at the twenty-third session of ISAR. Furthermore, country case studies of Pakistan, South Africa and Turkey were discussed at ISAR's twenty-fourth session.

2. In concluding its twenty-fourth session, ISAR requested the UNCTAD secretariat to continue conducting studies on practical implementation issues relating to IFRS, including on related topics such as implementation of international standards on auditing (ISAs). Accordingly, country case studies on practical implementation of IFRS covering Egypt, Poland, Switzerland and the United Kingdom – as well as a study on practical challenges and related considerations in implementing ISAs – were prepared for consideration by the twenty-fifth session of ISAR. The main objective of these papers is to facilitate sharing of experiences among member States.

3. This note provides a review of the current state of implementation of ISAs and highlights a number of practical challenges and related considerations that member States need to make in launching an effective ISAs implementation strategy.

## II. The benefits of globally uniform systems of financial reporting

4. As the world continues to globalize at a rapid pace through trade and investment, the credibility of financial information is becoming ever more important. Entities' securities offerings are no longer confined to their home jurisdictions, but are now often made in multiple jurisdictions. Similarly, investors and other providers of capital are increasingly looking beyond their own borders in making investment and other capital allocation decisions. The free movement of capital both within and across borders depends on credible, consistent and reliable financial reporting, which in turn rests on high quality standards of financial reporting.

5. However, the standards that govern financial reporting in a given jurisdiction need to be regulated at the national level, and these must therefore be national standards. Consequently, an entity with securities listed in more than one jurisdiction will be subject to the rules of both its home jurisdiction and the other jurisdictions where it is listed. The availability of different sets of financial information for the same entity, each of which is purporting to be a fair presentation, undermines the overall credibility of the financial information and makes the market inefficient. Equally, foreign investors looking to invest across borders face unnecessary costs in having to reconcile the financial information of potential investees in the local jurisdictions to the standards of the investors' home jurisdictions for investment appraisal purposes.

6. The way to lower the barriers to the free flow of credible financial information is not to choose a specific jurisdiction's standards and seek to impose them on every other jurisdiction – which would not be acceptable politically – but to agree on a “neutral” set of standards that can be accepted by every jurisdiction, either adopted as the jurisdiction's own standards or incorporated into them. That was the conclusion of

the Financial Stability Forum when it selected in March 2000 its 12 Key Standards for Sound Financial Systems.<sup>1</sup>

7. The benefits of globally uniform standards of financial reporting are numerous and include:

- (a) Greater comparability and transparency of financial information for investors;
- (b) Greater willingness on the part of investors to invest across borders;
- (c) Lower cost of capital;
- (d) More efficient allocation of resources; and
- (e) Higher economic growth.

8. Thus, adherence to international standards such as those developed by IAASB and the International Accounting Standards Board (IASB) can ultimately lead to greater economic growth around the world.

### **III. Towards global acceptance of ISAs**

9. Fundamental to the global acceptance of ISAs issued by IAASB is that they are developed through a comprehensive and transparent due process that all stakeholders recognize and accept. Equally important is the need for IAASB to build strong relationships with its stakeholders through which appropriate communication can be developed and mutual understanding enhanced.

10. This chapter explains the roles of IFAC and IAASB in establishing a single set of globally accepted auditing standards, and describes support around the world for global convergence with ISAs.

#### **A. The role of IFAC**

11. IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 157 members and associates in 123 countries and jurisdictions, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce.<sup>2</sup> IFAC, through its independent standard-setting boards, sets standards on auditing and assurance, education, ethics, and public sector accounting. It also issues guidance to encourage high quality performance by professional accountants in business.

12. Major reforms initiated five years ago have transformed IFAC and its international standard-setting processes. In March 2005, the most fundamental change in IFAC's 30-year history was announced: the formation of the international Public Interest Oversight Board (PIOB) to oversee, firstly, international standard-setting in the areas of auditing, education and ethics; and secondly, the IFAC Member Body Compliance Programme.<sup>3</sup> The formation of PIOB was one element of a

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<sup>1</sup> See [http://www.fsforum.org/cos/key\\_standards.htm](http://www.fsforum.org/cos/key_standards.htm).

<sup>2</sup> A list of IFAC members and associates can be accessed at: <http://www.ifac.org/About/MemberBodies.tmpl>.

<sup>3</sup> The IFAC Member Body Compliance Programme, which is overseen by IFAC's Compliance Advisory Panel, helps to support the development of the accountancy profession worldwide by encouraging IFAC members and associates to converge national standards with international standards, and to establish quality assurance and investigation and discipline programmes for their individual members.

comprehensive reform package that IFAC's leadership and the Monitoring Group of regulators<sup>4</sup> developed over a two-year period.

13. PIOB, which operates independently of IFAC, plays a key role in several ways:
- (a) It evaluates the due process in IFAC's standard-setting activities and reports publicly.
  - (b) It approves the process for nominating members to IFAC's standard-setting boards,<sup>5</sup> and the appointment of the chairs and other members of these boards;
  - (c) It has the right to require that the work programme or agenda of an IFAC standard-setting board include a specific matter;
  - (d) It has the right to be an observer, with floor privileges, at meetings of the IFAC board and those of IFAC's standard-setting boards.

## **B. The role of IAASB**

14. The objective of IAASB is to serve the public interest by setting, independently and under its own authority, high-quality standards for quality control, auditing, review, other assurance and related services engagements, and by facilitating convergence with those standards. This enhances the quality and uniformity of practice throughout the world, and strengthens public confidence in the global auditing and assurance profession.

15. IAASB consists of a full-time chair and 17 volunteer members from around the world. IAASB's composition is equally balanced between practitioners<sup>6</sup> and non-practitioners (including three public members).<sup>7</sup> This broad membership is intended to ensure that a range of experiences from different environments are brought to bear in IAASB's deliberations, and helps IAASB identify the best approaches when setting its standards. The appointment of IAASB members is made by the IFAC board and approved by PIOB. IAASB meets four or five times per year.

16. On the basis of IFAC reforms, IAASB has implemented a number of changes to its processes with a view to becoming one of the most transparent standard-setters in the world. IAASB's meetings are open to the public, and agenda papers, meeting summaries, and final pronouncements are freely available on its website.<sup>8</sup> Visitors can download audio recordings of IAASB meetings, exposure drafts of proposed standards and other consultative documents, and view all comments received on those documents.

17. IAASB has made public interest input into its standard-setting process a priority. It has established a formal Consultative Advisory Group (CAG)<sup>9</sup> to provide it with broad-based and continuous input on its work programme, project priorities and technical issues.

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<sup>4</sup> The Monitoring Group of regulators is comprised of the Basel Committee on Banking Supervision (Basel Committee), the European Commission, the Financial Stability Forum, the International Association of Insurance Supervisors, the International Organization of Securities Commissions (IOSCO) and the World Bank.

<sup>5</sup> IAASB, the International Accounting Education Standards Board, and the International Ethics Standards Board for Accountants.

<sup>6</sup> Practitioners are professional accountants in public practice with significant experience in the field of auditing and other assurance services.

<sup>7</sup> Public members are expected to act in the public interest and must be seen to be independent of any special interests and seen to be acting to represent society as a whole.

<sup>8</sup> <http://www.iaasb.org>.

<sup>9</sup> The IAASB CAG is currently comprised of representatives from 28 different organizations around the world, including regulators, investor and stock exchange organizations, regional accountancy organizations, and other professional bodies: <http://www.ifac.org/IAASB/CAG.php>.

18. IAASB also has three official observers, with floor privileges, from the European Commission (EC), the Japanese Financial Services Agency and the United States Public Company Accounting Oversight Board (PCAOB).

19. In addition, IAASB makes it a priority to reach out to other stakeholders. It holds an annual meeting with major national auditing standard-setters<sup>10</sup> (NSS), at which standard-setting matters of international relevance are discussed. IAASB also engages in ongoing dialogue with the EC and European national auditing standard-setters, principally to facilitate the process of convergence to ISAs in Europe. In addition, IAASB representatives regularly:

- (a) Meet representatives of IOSCO,<sup>11</sup> the Basel Committee, and the Forum of Firms;<sup>12</sup> and
- (b) Participate in meetings of the PCAOB Standing Advisory Group.

### C. IAASB's Clarity Project

20. In 2003, IAASB initiated a review of the drafting conventions used in its international standards to identify ways to improve the clarity, and thereby the consistent application, of those standards. After extensive public consultations, IAASB approved new drafting conventions in 2005 and launched a comprehensive programme to redraft its standards and to develop new standards using the new style ("Clarity Project"). This project marks one of the most important changes to international auditing standards in many years.

21. The project has a number of goals, of which the main one is the removal of any ambiguity in the language used in the standards that might affect the interpretation of the requirements. In addition, to help users understand clearly what the standards require, IAASB is introducing objectives into each standard, followed by separate sections that include respectively requirements and guidance. IAASB believes that applying the new conventions will assist in the adoption of the ISAs around the world and facilitate translation and global convergence. IAASB expects to complete the Clarity Project by the end of 2008.<sup>13</sup>

### D. Meaning of global convergence

22. In any discussion about global convergence, the debate usually concerns whether to adopt or adapt the international standards. Adoption refers to the incorporation of international standards into the national standards or to nationalize these standards through a national process that could include additions that do not conflict with the international standards. On the other hand, adaptation implies significant modification through rewriting. IFAC believes that the approach of rewriting the standards does not permit the greatest benefit of convergence to be achieved, which is to be able to state that the international standards have been applied. This was the conclusion that the United

<sup>10</sup> The countries currently represented in the IAASB–NSS liaison are Australia, Brazil, Canada, China, France, Germany, India, Japan, the Netherlands, New Zealand, South Africa, the United Kingdom and the United States.

<sup>11</sup> IOSCO issued a press release on 9 November 2007 to confirm that it is evaluating under what conditions it could endorse ISAs for use for cross-border purposes, and the form of such endorsement.

<sup>12</sup> Established in 2002, the Forum of Firms (FoF) is an association of international networks of accounting firms that perform audits of financial statements that are or may be used across national borders. Details of the FoF can be accessed at: [http://www.ifac.org/Forum\\_of\\_Firms/](http://www.ifac.org/Forum_of_Firms/).

<sup>13</sup> The ISAs issued under the Clarity Project will become effective for audits of financial statements for periods beginning on or after 15 December 2009. To allow time for translation and implementation, IAASB will not issue new ISAs between the date the Clarity Project is completed and the effective date of the Clarity ISAs.

Kingdom reached, for instance, when it chose to adopt the ISAs for all audits of financial statements for periods commencing on or after 15 December 2004.<sup>14</sup>

23. The introduction of modifications to the international standards because of particular legal reasons or circumstances should be an exception, not the norm.<sup>15</sup> It should be relatively convenient to adopt the international standards in their totality and then make any exceptions considered necessary. Generally, this is much more efficient and permits conserving a large part of the advantage of applying the international standards, for the ease of reconciling both national and international standards. For this reason, IFAC promotes adoption of ISAs rather than their adaptation.

24. To minimize the potential for conflicts with national circumstances, IAASB tries to promulgate ISAs that are “jurisdictionally neutral”. IAASB, however, accepts that some changes, if only in terminology, may be necessary to make ISAs readily applicable at the national level. For instance, the term “those charged with governance” as used in ISAs could be amended in an adopting jurisdiction where there is only one category of such individuals, for example, directors. In such a case, the national standard-setter might find it appropriate to use the term “directors” throughout the converged national standards, perhaps with an explanatory note in an appropriate place. Similarly, some options in ISAs that do not work locally (such as resignation of the auditor if this is prohibited) might be deleted for simplicity. Nevertheless, there needs to be recognition that the ISAs apply to all audits, including contractual ones. Therefore, what may seem like a good simplification to a statutory audit regulator may not work so well for the profession at large.

## **E. Support for global convergence**

25. IFAC has committed itself to achieving global convergence of national standards with international standards. This is evidenced both in its mission statement and in its Statements of Membership Obligations (SMOs). Published in April 2004, SMOs formally capture IFAC’s longstanding requirement that its member bodies support the work of IAASB and IASB by using their best endeavours to incorporate the respective international standards in their national requirements and to assist in implementing the international standards, or national standards that incorporate the international standards.

26. Widespread support for global convergence with ISAs is evidenced in ways such as the following:

- (a) The latest IFAC survey conducted in 2006 indicates that more than 100 countries or jurisdictions use auditing standards that are ISAs, either adopted as written or with essential jurisdictional changes, or national standards that are compared with ISAs to eliminate differences. Examples of these countries or jurisdictions include the following:
  - (i) ISAs adopted as written: Barbados, Chile, the Dominican Republic, Hong Kong (China), Jamaica, Kenya, Luxembourg, Malaysia, Namibia, Trinidad and Tobago, Uganda and Zambia;

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<sup>14</sup> See press release from the United Kingdom national auditing standard-setter, the Auditing Practices Board, at <http://www.frc.org.uk/apb/press/pub0530.html>.

<sup>15</sup> Where domestic considerations require changes to the international standards, either because of a conflict of law or some other local circumstance, it is for the national standard-setter to ensure that such matters are appropriately dealt with at the local level. But care is necessary to ensure that the ISAs are not undermined by country changes. IAASB has developed a policy statement – *Modifications to International Standards of the International Auditing and Assurance Standards Board (IAASB): A Guide for National Standard-Setters that Adopt IAASB’s International Standards but Find it Necessary to Make Limited Modifications* – to help national standard-setters that adopt the ISAs to decide what type of variation might be permitted, while preserving the ability to deem the resulting standards compliant with ISAs: [http://www.ifac.org/IAASB/downloads/Modification\\_Policy\\_Position.pdf](http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf).

- (ii) ISAs adopted as national standards but with essential jurisdictional changes to address legal or regulatory conflicts: Australia, Bangladesh, the Czech Republic, Denmark, Finland, France, Germany, Haiti, Israel, Italy, the Netherlands, New Zealand, Norway, the Republic of Korea, South Africa, Sri Lanka, Sweden, Switzerland and the United Kingdom;
  - (iii) National standards compared with ISAs to eliminate differences: Japan, Mexico, Portugal and Saudi Arabia;
- (b) An independent report – Rebuilding public confidence in financial reporting: an international perspective<sup>16</sup> – has recommended achieving convergence of national and international standards as soon as possible, viewing this as a significant public interest issue;
- (c) The International Organization of Supreme Audit Institution's<sup>17</sup> (INTOSAI) Guidelines for Financial Audit, which provide INTOSAI members with practical guidance on the application of the INTOSAI Auditing Standards to public sector audits, are based upon ISAs;
- (d) Many of the world's major capital markets accept the use of ISAs for the audit of financial statements of foreign issuers. A recent IAASB survey indicates that 20 of the 23 largest capital markets, with overall market capitalization of 56 per cent of the world total, accept ISAs for this purpose;
- (e) The World Federation of Exchanges<sup>18</sup> has formally endorsed the processes for establishing ISAs and recognized their importance, viewing them as key to the development of a globally uniform financial reporting system;
- (f) The World Bank, which jointly with the International Monetary Fund has instituted a programme of Reports on the Observance of Standards and Codes (ROSC) by countries, uses ISAs as the benchmark for assessing the quality of national auditing standards;
- (g) The members of the Forum of Firms have committed to have policies and methodologies for the conduct of transnational audits that are based, to the extent practicable, on ISAs.
27. At the country or jurisdictional level, convergence with ISAs is occurring rapidly in many parts of the world. Recent developments include, for example, the following:
- (a) The Statutory Audit Directive in the European Union specifies that ISAs will be used for all audits in all member States. The EC is currently considering the endorsement of ISAs as those international standards;
  - (b) The Canadian Auditing and Assurance Standards Board, after careful consultation, has decided to move its standards to ISAs. These will be adopted in Canada in concert with IAASB's Clarity Project and will come into effect for audits of financial statements for periods beginning on or after 15 December 2009;<sup>19</sup>
  - (c) The American Institute of Certified Public Accountants' Auditing Standards Board has announced a formal convergence plan with ISAs for audits of non-public entities in the United States. The board has stated its belief that the IAASB's clarity effort will provide an excellent basis for improving United

<sup>16</sup> <http://www.ifac.org/Store/Details.tmp?SID=1186509159170528&Cart=1214922730491403>.

<sup>17</sup> INTOSAI is the representative organization of supreme audit institutions, which are central government auditors.

<sup>18</sup> The federation represents 57 securities and derivative markets accounting for more than 97 percent of world stock market capitalization.

<sup>19</sup> <http://www.cica.ca/4/1/0/8/8/index1.shtml>.

States generally accepted auditing standards applicable to audits of non-issuers (non-listed companies).<sup>20</sup>

- (d) The major emerging BRIC (Brazil, Russian Federation, India and China) countries have established convergence policies to bring their national auditing standards closer to ISAs. For instance, Brazil and India have developed action plans to achieve convergence by 2010.

## **IV. Addressing the practical challenges in implementing ISAs**

28. As organizations and countries increasingly commit to convergence of national auditing standards with ISAs, predominantly through adoption mechanisms, there is a need to ensure that global convergence is approached in a systematic and, where possible, consistent way across jurisdictions. Also, interested parties such as national standard-setters, regulators and firms need to understand the challenges in implementing ISAs, so that these can be met at an early stage.

29. While adoption and implementation are two distinct matters, it is difficult to discuss one without considering the other. Adoption, as explained earlier, involves the incorporation of ISAs into national standards or the process of nationalizing them. Implementation, on the other hand, refers to the effective introduction and application of ISAs by practitioners. The adoption of ISAs is generally the more straightforward part, although adoption timetables do need to have regard to practitioners' ability to implement effectively. Implementation, by contrast, is the more difficult task, and the practical challenges are often greatly underestimated. Effective implementation requires, among other things, the availability of ISAs, time to learn them and to make necessary changes to audit systems and methodologies, and the existence of adequate monitoring. While implementation itself is a challenge, it will be enormously facilitated if it is backed by a decision to adopt ISAs based on firm convictions.

30. To foster debate on, and awareness of, the challenges to implementing international accounting and auditing standards, IFAC in September 2004 published an international study – Challenges and successes in implementing international standards: achieving convergence to IFRS and ISAs (the Wong report) – that identifies the challenges to adopting and implementing IFRS and ISAs. The Wong report also provides examples of successful adoption and implementation to serve as models for other countries, and recommends actions to be taken by all those in the financial reporting supply chain to achieve convergence to international standards.<sup>21</sup>

31. The following sections discuss what it takes for successful implementation of ISAs, focusing on some of the main implementation challenges identified in the Wong report (some more concrete than others), bearing in mind that the implications will vary with national circumstances.

### **A. The need for a robust implementation strategy and action plan**

#### **1. Understand the nature and scale of changes required, and plan accordingly**

32. A critical success factor in implementing ISAs is the existence of a robust strategy and action plan backed by adequate resources to carry them through. Often, difficulties arise because of the lack of a coherent implementation strategy at the national level. This, in turn, can be the result of a misunderstanding as to the extent of the challenge and the scale of changes required, leading to inadequate planning and preparation for the actual

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<sup>20</sup> [http://www.aicpa.org/download/auditstd/Clarity\\_Project\\_Explanatory\\_Memorandum.pdf](http://www.aicpa.org/download/auditstd/Clarity_Project_Explanatory_Memorandum.pdf).

<sup>21</sup> The Wong report was prepared by former IFAC board member Peter Wong: [http://www.ifac.org/Members/Source\\_Files/Other\\_Publications/Wong\\_Report\\_Final.pdf](http://www.ifac.org/Members/Source_Files/Other_Publications/Wong_Report_Final.pdf).



implementation effort. Misunderstandings may also arise regarding the nature of the ISAs to be implemented and what it means to assert compliance with them.<sup>22</sup> For example, the World Bank noted in its September 2004 report – Implementation of international accounting and auditing standards: lessons learned from the World Bank’s accounting and auditing ROSC programme<sup>23</sup> (ROSC report) – that some countries have adopted only selected ISAs, or those in force at a particular date in the past, with no account taken of changes since then.

33. Selective adoption of ISAs may also be due to their perceived complexity, their incompatibility with national culture, or other potential implementation problems. As the Wong report noted, for example, “in one country, the ISAs were summarized in 33 pages, as the complete standards were felt to be ‘overwhelming.’ The implementation of these summarized ISAs was intended to be a first step to full adoption; however, that country is now in the sixth year of this temporary stage.”

34. Clearly, the nature of the required changes to national auditing standards will vary from country to country, depending on the extent of similarity between these and the ISAs. The challenge, however, is to fully understand the scale of the changes and time-frame needed for appropriate implementation, and to develop and implement an appropriate strategy and action plan accordingly. In this regard, IFAC, through its Compliance Advisory Panel, is working closely with its member bodies to facilitate this process. From the latest data available from part 3 of IFAC’s Compliance Programme,<sup>24</sup> some jurisdictions, such as mainland China, appear to be further along in the process of developing concrete action plans than others.<sup>25</sup>

35. Decisions to implement other international standards – such as IFRS and IFAC’s Code of Ethics – may also affect the development of an appropriate strategy and action plan to implement ISAs, particularly if the implementation of all the international standards occurs more or less concurrently. Consistent implementation strategies will be required across the different sets of standards to ensure that the overall approach is coherent and efficient.

## **2. Plan to obtain the commitment and engagement of all relevant stakeholders**

36. The implementation of the ISAs should not be solely a practitioner burden. Successful implementation requires the commitment and engagement of all relevant stakeholders, and the key to achieving it may be through a top-down approach.

## **3. Obtain regulatory backing**

37. First and foremost, a robust implementation strategy needs to incorporate regulatory backing for granting national authority to international standards. This may require changes to the legal and regulatory frameworks in many jurisdictions that only recognize nationally-developed standards. As the World Bank noted in its ROSC report:

“To be effective in a national setting, international standards require the force of law or other regulatory backing. If not, compliance becomes a matter of

<sup>22</sup> For national auditing standards to be regarded as being in compliance with ISAs at a given time, they should include all of the requirements and guidance of the latter that are effective at the time.

<sup>23</sup> [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/01/22/000333037\\_20080122014815/Rendered/PDF/419530WP0LessoIned1ROSC1AA01PUBLIC1.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/01/22/000333037_20080122014815/Rendered/PDF/419530WP0LessoIned1ROSC1AA01PUBLIC1.pdf).

<sup>24</sup> Part 3 of IFAC’s Compliance Programme requires IFAC member bodies to develop action plans to address identified performance and quality gaps in their compliance with IFAC’s SMOs, including convergence with IAASB standards.

<sup>25</sup> A copy of mainland China’s action plan for converging with and implementing ISAs, which was prepared as part of IFAC’s Chinese member body’s efforts to comply with IFAC’s SMO 3, can be accessed at <http://www.ifac.org/ComplianceAssessment/published.php>.

non-transparent discretion on the part of preparers and auditors of financial statements, outside the constraints of any regulatory framework. Although the accountancy profession has played a major role in the development of international standards, and in their promotion at a national level, the profession itself does not have sufficient authority to ensure their successful implementation, unless acting in a regulatory capacity derived from specific legislation.”

38. In some jurisdictions, a legislative process may be required for adoption, which can itself be lengthy, especially if the ISAs must go through an endorsement process. The Russian Federation, for example, is in the process of enacting necessary amendments to its legal framework and has established an endorsement process for Russian Standards of Audit, which are the translated versions of ISAs. In the EU, the EC is considering the establishment of an endorsement mechanism for the adoption of ISAs under the Statutory Audit Directive, although the legislation has not set a deadline for the EC to make a decision regarding adoption.

#### **4. Assign specific roles for implementation and establish accountabilities**

39. For the implementation effort to be successful, key parties should be identified to lead it. While national standard-setters will be primarily responsible for the process of converging national standards with ISAs, responsibility for providing implementation support will often rest with the national professional accountancy bodies, as they are the ones that are closer to their member-practitioners. In some cases, that responsibility may be shared. The challenge is making sure that responsibilities for the various aspects of implementation are identified and communicated early, through dialogue among all the relevant parties, and that these parties accept to be accountable for such responsibilities.

40. One example of an approach taken in this regard is the ISA Implementation Group that the United Kingdom established when it adopted ISAs. This group comprised regulators, professional accountancy bodies, practitioners, training consortia, examiners and publishers, with the national standard-setter acting as observer. Division of responsibility has worked out reasonably well in the United Kingdom in specific respects. For instance, the national standard-setter has developed implementation guidance addressing specific areas of ISAs, such as audit documentation, while the local accountancy bodies have taken charge of arranging road shows, facilitating training or providing other support for practitioners.

41. In other countries – such as Canada, China and India, where the local accountancy bodies also have responsibility for standard-setting – there may be a need for these bodies to shoulder the task of both converging the national standards with the ISAs and implementing the standards.

#### **5. Engage practitioners and the public**

42. Often, a significant challenge to effective implementation of ISAs is simply practitioners’ resistance to change. There may be a number of reasons for this. For example, cultural barriers may exist whereby practitioners are reluctant to embrace practices that encourage greater probing and transparency, especially in countries where a significant proportion of businesses are family-owned and controlled. Practitioner inertia may also be an impediment in itself, especially at the smaller end of the market, where the audit of financial statements may not be the main revenue generator and where capacity constraints exist. Recent surveys in Australia and New Zealand, for example, have consistently revealed a lack of awareness of developments in international standards within the smaller practitioner community.

43. The key to addressing this challenge is to engage practitioners at all levels. An effective implementation strategy will incorporate initiatives to involve practitioners in the implementation process, through training and active consultation on exposure drafts and implementation issues,<sup>26</sup> and to raise their awareness of the changes to the standards<sup>27</sup> and the changes needed to such matters as audit systems and methodologies.

44. Equally important will be the need to publicize widely the implications of implementing the ISAs in order to manage the public's expectations, especially given that some of the start-up costs that will be incurred in the first year of implementation may need to be borne by businesses and, ultimately, their shareholders. One of the lessons learned from the United Kingdom's implementation of ISAs is that the process should involve more investors. The United Kingdom now has a high level Audit Quality Forum that engages all audit stakeholders, and this has helped promote greater understanding among them. It has also experienced the need to better engage the professional media in the implementation process, as damage can be caused by uninformed comment.

45. By and large, however, anecdotal evidence from the United Kingdom's adoption of ISAs suggests that businesses have generally been receptive to the added value provided by audits under the new standards because of the focus on business controls and the greater probing required in relation to risks and fraud. In particular, weaknesses in systems that client management were not previously aware of have been brought to light by the new audit procedures.<sup>28</sup>

## 6. Plan an appropriate transition strategy

46. Another key factor for an effective implementation of the ISAs is the development of an appropriate transition strategy. There are three particular aspects to this. Firstly, a decision needs to be made as to whether to take a "big-bang" or piecemeal approach to convergence. With the former, all ISAs are adopted at the same time, whereas with the latter, they are adopted in drip-feed fashion. A piecemeal approach will generally be difficult to implement because of the close interrelationship among the ISAs, the difficulty of running two sets of standards concurrently, and the issue of practitioners having to make constant adjustments as new ISAs are adopted. Examples of jurisdictions that have chosen a big-bang approach to convergence include Australia, Canada, Hong Kong (China) and the United Kingdom.<sup>29</sup>

47. Secondly, to give practitioners ample time to plan and prepare for implementation, a clear and early communication is needed regarding when the new standards will become effective, what the transitional provisions, if any, will be, and how these relate to the corresponding provisions in the ISAs. A model to follow in this regard is Canada, where national standards will make the transition to ISAs issued under the IAASB's Clarity Project and will become effective at the same time as the revised ISAs.<sup>30</sup>

<sup>26</sup> An example of a consultative channel is the IFAC SMP Committee's SMP/SME discussion board at: <http://web.ifac.org/forum/SMP/1>.

<sup>27</sup> An example of an initiative to raise awareness is CPA Australia's fact sheets at: [https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECA-6DDB40C7/cpa/hs.xsl/1019\\_22187\\_ENA\\_HTML.htm](https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECA-6DDB40C7/cpa/hs.xsl/1019_22187_ENA_HTML.htm).

<sup>28</sup> See the paper Audit-exempt companies – beyond the threshold, developed by the Institute of Chartered Accountants in England and Wales (ICAEW) at <http://www.icaew.com/index.cfm?route=141483>.

<sup>29</sup> The United Kingdom experience of adopting ISAs is described in the ICAEW's November 2006 report Audit quality fundamentals – making global auditing standards local: <http://www.icaew.com/index.cfm?route=143423>.

<sup>30</sup> To assist Canadian auditors in preparing for the transition to ISAs, the Canadian Institute of Chartered Accountants has issued a guide, The CICA's guide to ISAs in Canada, to explain the expected impact of the adoption of ISAs in Canada and how practitioners can prepare for the transition: [http://www.cica.ca/download.cfm?ci\\_id=44176&la\\_id=1&re\\_id=0](http://www.cica.ca/download.cfm?ci_id=44176&la_id=1&re_id=0).

48. Thirdly, once the national standards have converged with the ISAs, there is a need to keep the body of those standards current with the ISAs to derive the benefit of the latest improvements to international practices.

49. Evidence from the Wong report indicates that the above matters often present practical difficulties. For example, it noted that, in some cases, countries have adopted the international standards at issue at a particular date but have not kept up to date with new and revised international standards issued subsequently. In other cases, the national standards have different effective dates and transitional provisions from those of the international standards on which they are based. These issues undermine the ability of practitioners in these countries to make positive statements regarding compliance with the international standards.

## **B. The need for an adequate implementation support infrastructure**

50. For the implementation of the ISAs to be effective, there needs to be an adequate support infrastructure. There are a number of different aspects to this.

### **1. The need for adequate dissemination channels**

51. First and foremost is the need for adequate channels to disseminate the standards, whether through print-based media or via the Internet. While IAASB endeavors to facilitate dissemination to the greatest extent possible by making the ISAs accessible and downloadable from its website free of charge, this is not, in itself, sufficient to ensure that the standards reach all practitioners around the world. This is because the ISAs are written in English, and for them to have the widest possible distribution they need to be translated and disseminated on a national basis in jurisdictions where English is not the national language. This issue is likely to be most acute in developing countries and countries with economies in transition (“developing and emerging economies”) that lack the resources and capacity to ensure timely dissemination of the standards. Research undertaken in Jordan, for example, indicates that ISAs have not been widely available and that many audit practitioners have not had access to ISA-based practice manuals. Knowledge deficiencies therefore constrain most Jordanian auditors in ensuring sound auditing practice.<sup>31</sup>

### **2. The need for implementation guidance and related support tools**

52. A further challenge is the lack of implementation guidance and other support tools to assist practitioners in understanding and applying ISAs. This issue affects practitioners in developed countries, but even more so in developing and emerging economies, due to the lack of capacity. One option in addressing the challenge is to share knowledge and resources with other countries that face similar challenges. Thus, through collaboration, common implementation guidance and related support tools could be developed and, if necessary, subsequently customized nationally. Another option is for national standard-setters and professional accountancy bodies to seek assistance from their counterparts in other countries that are further along in the implementation process.

53. Through its annual liaison with the major national standard-setters, IAASB is working to facilitate cooperation among those standard-setters in developing relevant implementation guidance and other support tools. Further, in response to demands from many of its stakeholders, IAASB has agreed to undertake a number of initiatives as part of its recently released Strategy and Work Programme 2009–2011<sup>32</sup> aimed at providing further implementation support for practitioners. While it is too early at this stage to

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<sup>31</sup> Obaidat AN (2007). Auditors compliance with international standards on auditing: evidence from Jordan. *Journal of Social Sciences* 3 (4): 185–189. Tafila Technical University.

<sup>32</sup> <http://www.ifac.org/store/Details.tpl?SID=1216051339304536&Cart=1216062762308775>.

indicate what form such implementation support might take, IAASB and IFAC recognize the importance of their roles in contributing to the successful implementation of ISAs.<sup>33</sup>

### 3. The need for an adequate oversight and quality assurance infrastructure

54. An effective implementation strategy should address the challenge of putting into place an adequate oversight and quality assurance (QA) infrastructure. Work in relation to this should develop on three distinct fronts. First is the need to establish effective monitoring and enforcement mechanisms managed by a recognized oversight body nationally to ensure a high quality of application of ISAs. Often, these mechanisms will need to be coordinated with other oversight programmes in relation to other aspects of financial reporting to ensure a consistent and coherent regulatory framework. Second is the need for the national accountancy profession to institute strong self-enforcement practices, including the establishment of adequate investigation and disciplinary mechanisms to ensure compliance with ISAs. And third is the need to implement adequate quality control systems at the audit firm level. Policy and goal setting should be exercised on each of these fronts simultaneously, as synergies exist, and should be exploited for the achievement of an effective overall result.

55. Although significant efforts have been made in recent years to enhance the capacity and powers of various regulatory bodies in a number of developed countries, findings from the World Bank's ROSC programme indicate that monitoring and enforcement practices in many developing and emerging economies remain inadequate and need to be strengthened. In addition, one of the findings of part 2 of IFAC's compliance programme is that only 40 per cent of developing and emerging economies responding have any form of QA programme. Clearly, this is an area where much work remains to be done. Perhaps a solution might be found on a regional basis, or at least a common project on the design, development and implementation of appropriate QA systems.

56. Further challenges that responsible bodies face in establishing appropriate QA systems include access to experienced and trained reviewers, developing appropriate guidance so that audit firms have a basis for good practice,<sup>34</sup> and providing training so that practitioners can continuously improve on matters identified as part of the QA process. Through its membership obligations, IFAC already requires each of its members and associates to establish a QA programme or assist in the development and implementation of such a programme.

## C. Addressing the challenges of training and education

57. Once the decision to converge with ISAs has been made, significant logistical challenges need to be addressed in training and educating users in applying the new standards.

### 1. The capacity-building issue

58. The ability to address the challenges of training and education effectively depends on the availability of an adequate pool of appropriately qualified individuals. This in turn depends on the availability of opportunities for relevant and adequate education, training and experience. As the World Bank's ROSC report noted, "the greater the gap between

<sup>33</sup> IFAC's International Center for SMPs has various resources, including a catalogue of useful links offering access to free materials, including implementation tools, at [http://www.ifac.org/SMP/relevant\\_links.php](http://www.ifac.org/SMP/relevant_links.php). IFAC has also developed a search tool for practitioners at [www.ifacnet.com](http://www.ifacnet.com).

<sup>34</sup> Recognizing the need that exists, IFAC's Small and Medium Practices (SMP) Committee is currently developing a guide for release in early 2009 to assist SMPs in implementing IAASB's International Standard on Quality Control. The guide is primarily aimed at IFAC member bodies and, through them, their members working in SMPs and in countries where the profession is in a developmental phase.

existing national and international standards, and the shorter the period to complete the transition, the greater the capacity-building challenge to overcome. The development and enhancement of capacity applies to educators, regulators and... auditors, and places demands on both institutions and individuals. Systems, methodologies, application guidance, curricula, teaching and training materials, examination and certification procedures, and much else must be adapted to support the new obligations.” Naturally, the time needed to plan for and implement these changes acts as a drag on the process of capacity-building. For example, when it adopted ISAs, the United Kingdom identified the time lag for new ISAs to be introduced into university and professional education curricula as a specific issue.

59. The challenges of training and education will be greatest in developing and emerging economies that lack the capacity, both human and financial, to lead the implementation effort. A coordinated response at the national level involving Government, the national standard-setter, local accountancy bodies, academic institutions, private sector training and other support organizations, and audit firms, is therefore critical to ensure that adequate levels of capacity can be built up over time. Where appropriate, donor funding should be sought for purposes of capacity-building. Consideration should also be given to collaborative arrangements with other jurisdictions that have developed expertise. Such arrangements may take the form of, for example, train-the-trainer courses designed to equip individuals with the skills and knowledge necessary to train others in their home jurisdictions.

60. One model of a cooperative approach to the challenges of training and education is the United Kingdom. Although United Kingdom auditing standards were substantially aligned with previous versions of ISAs, planning for adoption and implementation of ISAs took place over a period of more than three years and required cooperation among the United Kingdom auditing standard-setter, the national accountancy bodies, private sector training consortia and software providers, and practitioners. This cooperation helped to ensure that when the change to ISAs was implemented, practitioners were adequately prepared and ready for the change.<sup>35</sup>

61. It is also worth mentioning the important but often underappreciated role of the global audit firms in developing and emerging economies in building capacity and promoting higher levels of training, professional education and competence through their commitment to using ISAs.

## **2. Addressing the technical challenges**

62. Challenges also arise from a technical standpoint in relation to the interpretation of new requirements introduced by ISAs, especially given that significant changes do not always get absorbed immediately. Even in a developed market such as the United Kingdom, evidence from monitoring undertaken by ICAEW indicates that some requirements of ISAs have not been consistently interpreted, especially in the areas of risk assessment, internal control testing and audit documentation.

63. The technical challenges are often significant for smaller audit firms around the world that often lack in-house expertise to support implementation of ISAs. It is at this end of the market that the needs for implementation support are likely to be most felt. Recognizing this, IFAC has been working to provide practical support to SMPs to raise their capacity to implement ISAs efficiently and effectively. This includes the development of a Guide to using international standards on auditing in the audit of small and medium-sized entities (ISA Guide),<sup>36</sup> and the provision of Web-based information resources (see

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<sup>35</sup> See footnote 29.

<sup>36</sup> Published in December 2007, the ISA Guide (<http://www.ifac.org/Store/Details.tmpl?SID=1197644225547443&Cart=1215023902253>) is primarily intended to help practitioners around the world understand, comply with and apply ISAs in

footnote 33). However, even the global audit firms that are generally up to date with ISAs may experience challenges in training and educating their audit personnel to ensure consistent application across their international networks, especially in relation to ISAs that have been redrafted, or revised and redrafted, under IAASB's Clarity Project.

64. A related issue in raising the quality and consistency of application of ISAs worldwide is the effect that the cultural environment may have on the interpretation of the requirements. In particular, key concepts such as professional skepticism and judgment may not be interpreted as intended by IAASB, especially in jurisdictions that do not have a culture of questioning authority. Other important concepts such as "tone at the top," ethical values and independence may also be relatively new or not clearly appreciated, especially in environments where moral integrity is not prized and corruption is commonplace. The challenge, therefore, is in educating practitioners not only to understand the technical meaning of the requirements in ISAs, but also to embrace the appropriate mindset when applying them.

65. Some early evidence of improvements in audit quality comes from countries that have already adopted ISAs. For example, respondents to a survey carried out as part of a project commissioned by IFAC on the financial reporting supply chain reported seeing improvements in the auditing process, such as a more systematic approach and analytical reviews with emphasis on risks and controls.<sup>37</sup> They also indicated that more demanding standards require auditors to gain a better knowledge of the audited entities and a deeper understanding of these entities' financial reporting processes.

#### **D. The need for timely and high-quality translations of ISAs**

66. Successful implementation requires a significant commitment to the translation of ISAs, to assure that the translation is adequate from the technical point of view, that it is timely and that it is readily available. The task of translation is not simple, and it requires the mobilization of adequate and appropriate resources. Two specific issues need to be considered.

67. Firstly, the translation of ISAs cannot be made in literal form. The translation process must involve individuals with the proper knowledge of the language, and who are also knowledgeable about the technical aspects of the standards, to assure that the concepts included in the standards are adequately translated. This, however, is not always the case, especially in those countries where translation is undertaken by the regulator or a government body. In such cases, interpretative guidance and additional translations may be required.

68. Secondly, the version of the body of ISAs being adopted in some countries relative to the latest effective ISAs issued by the IAASB leaves room for concern. For example, the Wong report noted that one country had a five-year time lag in adopting ISAs, due to the need to translate the standards.

69. Depending on the processes followed, some countries translate the standards issued by IAASB in groups at appropriate dates. Other countries issue the standards quickly following each IAASB meeting. Some countries have to get space on a legislative agenda to make changes to auditing standards. The varying timing of translation in different countries results in the implementation of different sets of ISAs around the world, which

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small and medium-sized entity audits. IFAC has distributed an electronic version to all its member bodies free of charge, which they will be able to use for their own local adaptations and as a basis for developing other support products, e.g. audit software, checklists, forms and training materials.

<sup>37</sup> *Financial Reporting Supply Chain: Current Perspectives and Direction*: <http://www.ifac.org/Members/Pubs-Details.tml?PubID=12047550542246268&Category= Other>.

undermines the goal of global convergence. It is therefore particularly important that countries remain up to date in their translation efforts.

70. It should be noted that translation challenges also arise for the larger audit firms that need to use the same audit systems and methodologies based on ISAs across their international networks.

### **Opportunities for collaboration on translation**

71. Translation is an area in which agreements of collaboration should be sought between professional accountancy bodies or other organizations in different countries, to minimize duplication of effort and to ensure consistent translations. One example of this is the 2005 agreement that IFAC signed with two of its member bodies – Compagnie Nationale des Commissaires aux Comptes (CNCC) in France and Institut des Reviseurs d'Entreprises (IRE) in Belgium – to translate ISAs into French. CNCC and IRE worked with other French-speaking professionals from Canada, Luxembourg and Switzerland to build on existing translations and develop a single French version of ISAs for implementation throughout the world.<sup>38</sup>

## **V. Conclusion**

72. The implementation of ISAs presents significant practical challenges that require a coordinated response at the national level involving all relevant stakeholders, including Government, regulators, national standard-setters, professional accountancy bodies, audit firms and practitioners, training organizations and third-party suppliers. An effective country strategy should establish priorities, responsibilities for planned actions (including communication), and a realistic timeframe for implementation. It should also specify the human and financial resources required, and how these should be mobilized on a sustainable basis to initiate and continue the implementation effort.

73. IFAC and IAASB are contributing to the implementation effort in a variety of ways, such as through the provision of Internet resources that others can leverage, and initiatives to assess both the impact of proposed new ISAs and the effectiveness of implementation of ISAs. Equally significant is the high level of outreach to stakeholders that both IFAC and IAASB are committed to undertaking to ensure that the challenges of implementation are understood and addressed, and the benefits fully appreciated.

74. IFAC recognizes that developing and emerging economies will not have the financial and technical means to achieve all the actions necessary for successful implementation of ISAs. The support of relevant organizations in developed countries, or those with regional mandates, acting as mentors to those in developing and emerging economies, and the development of implementation support and tools, will increasingly become very important. In addition, it will be crucial to encourage national Governments to make convergence to and implementation of ISAs a priority on their agendas, and donor agencies to invest in the development of implementation support. Ultimately, the success of developing and emerging economies in effectively implementing ISAs will depend on their ability to clearly communicate their challenges, required actions and need for resources, and the willingness of Governments, donor agencies and developed countries to provide assistance wherever possible.

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<sup>38</sup> To increase accessibility worldwide, the IFAC Board has approved a proposal to move to one quality translation of IFAC standards per language and to consult publicly on the process to achieve this: <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0110>. IFAC also has a translation database featuring a listing of IFAC publications that have been translated, along with the name of the translating body and links to a list of key terms, where it exists: <http://www.ifac.org/Translations/database.php>.