

## “CHANGING ROLE OF AUDITING WITH IFRS”

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### INTRODUCTION

The prime reason for carrying out an audit process is to obtain a Financial Statement that is free from flaws. Only the financial statement can reveal the company's real economic value. Both the undervaluation and overvaluation of the assets results in the projection of incorrect economic value of the company. The financial statement acts as a medium of communication between the shareholders and the company. A financial statement only helps to achieve the objectives of the organization and also to make necessary changes in organization according to the changing circumstances. Thus change in the role of auditing plays a vital role in the eve of global exposure to IFRS. Changing the role of auditing can be done in order to provide greater assurance for the quality of the financial statements. IFRS (International Financial Reporting Standards) is single set of high quality accounting standards. The auditor's role in adoption of the IFRS is a cardinal one.

### AUDITING

The accounts of an entity are maintained, and the financial statements at the end of an accounting period are prepared, by the management. Since it is the management who run the organization and it is they who prepare the financial statements, the various stakeholders, from investors to the government, who are interested in such accounting information, need an assurance that such information can, indeed, be relied upon. It is here, that an auditor comes into picture. Thus need for an audit arises.

Auditing is an independent examination of financial information with a view to pass an opinion on the true and fair view presented by the financial statements of an entity.

### STATUTORY RESPONSIBILITY OF AUDITOR TO REPORT FRAUD

Companies Audit Report order, 2003 (CARO) requires an auditor to report certain information in the form of an annexure, in addition to the auditor's report normally furnished. Clause (XXI) of the CARO requires the auditor to report whether the auditor has noticed any fraud by the company or any fraud on the company during the year.

### RESPONSIBILITIES AND DUTIES AS AN AUDITOR

The basic question one has to understand in financial reporting and audit of financial statements is - who is responsible for preparation of financial statements? SA200 - "overall objective of the independent auditor and the independent auditor and the conduct of an audit" clearly says that the financial statements subject to audit are prepared and presented by the management of the entity. Thus it is the duty of the management to prepare the financial statement devoid of any material misstatement. The auditor is merely required to obtain reasonable assurance that the financial statements are free of material misstatement, whether due to fraud or error.

- Understand the entity and its environment in place.
- Consider the applicable laws and regulation to the entity.
- Analyze internal controls - its existence and effectiveness.
- Communicate deficiencies in internal control and other deficiencies to the management and those charged with governance.
- Identify and assess the risk of material misstatement.
- Document every audit procedure performed, finding and observation.
- Seek external confirmation.
- Use the work of an expert and peruse the internal auditors report.
- Plan the audit to identify any misstatement.

- Evaluate the misstatement.
- Related parties transaction has to be thoroughly scrutinized.
- Carry out analytical procedures.
- Obtain written representation from management.
- Prepare report appropriately and opine based on materiality.

### AUDIT OPINION

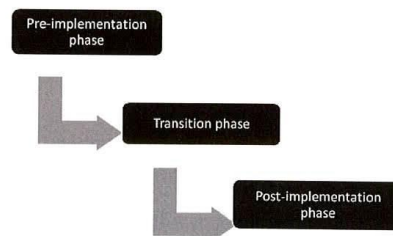
The auditors another important role is to express his opinion on the financial statement prepared. An opinion can be classified under four categories.

### INTERNAL AUDIT'S RESPONSIBILITY IN IFRS PROCESS

Conversion to IFRS must be considered and managed like any other implementation of large scale project. Internal auditing must act as a key player in the IFRS initiative process because IFRS has a pervasive impact on the organization's internal control environment and in all its process. Here are some ways in which internal auditors should get involved in its organization's IFRS project.

### INTERNAL AUDIT'S RESPONSIBILITY IN IFRS

#### PROCESS



### DURING THE PRE-IMPLEMENTATION PHASE

The accounting/finance department should be in charge of the entire IFRS project. Therefore the internal auditor's step is to review the organization's IFRS project plan to ensure the company is prepared appropriately to undertake the project. Internal auditors should ensure the project is designed and scoped adequately and managed effectively and efficiently. By beginning the IFRS conversion project

with a thorough pre-implementation review, internal auditors will likely give the project a better chance of success.

#### DURING THE TRANSITION PHASE

Internal auditors should work closely with the external auditors throughout the IFRS implementation process and help to identify the processes, systems and controls impacted by IFRS. After identifying affected items, internal auditors should make appropriate updates on process documentation to make sure affected areas and controls function properly in the new IFRS environment.

#### DURING POST-IMPLEMENTATION PHASE

After implementation phase, internal auditors should validate the process around newly created IFRS financial statements by providing assurance to management that the revised internal control structure is working properly and yields accurate financial reports.

#### INTERNAL AUDIT'S ROLE IN A SUCCESSFUL IFRS CONVERSION

The adoption of IFRS will bring more transparency and a higher degree of comparability, both of which promise many benefits for the organizations as well as economies. The transition to IFRS and the responsibility of making appropriate Accounting treatments and necessary disclosures comes within the purview of accounts department.

#### INTERNAL AUDIT CAN AND SHOULD PLAY A KEY ROLE IN ASSESSING ORGANIZATIONAL READINESS BY

- Identifying project risks (e.g. operational, financial reporting, resources) in the planning stages
- Focusing on control over the change management process and the impact on internal control over financial reporting and disclosure controls and

procedures

- Informing the company's board and senior management (and soliciting feedback from the same) on the status and progress of IFRS readiness and implementation.

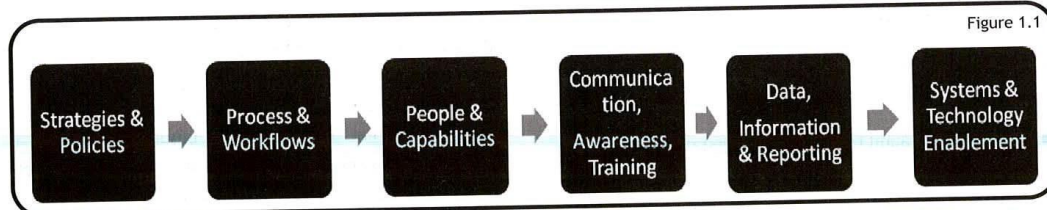
"Internal audit is an independent appraisal activity within an organization for the review of accounting, financial, and other operations as a basis for service to management."

Internal audit must focus on what is suitable for the transition. And also has to decide whether the company has to change everything or can apply for changes that can be done in some collaborative way. Any internal auditor engaged in auditing an IFRS conversion or convergence project should not just audit whether the accounting policies are correctly followed and then audit them against that standard, but he must also get involved with the convergence effort in depth as a project. Internal auditors must be concerned about some details whether the project is on time and on budget, that it is well managed and meeting the audit committee's expectations.

The internal auditors should be there to assist them challenge the process and make sure the companies are doing everything they should do to move towards with such a significant project. Internal auditors need to test the new designs and implementation of new controls to ensure that controls are working effectively in the changed environment. After the implementation phase, the auditors must re-evaluate the entire process flow of all activities right from its initiation till its inclusion in the IFRS financial statements. It should test the internal control structure in order to provide assurance to the management that the revised internal structure works properly and yields better & accurate financial reports.

#### THE CONVERSION FROM GAAP TO IFRS WILL ALSO HAVE AN OVERALL IMPACT ON SIX ELEMENTS OF INFRASTRUCTURE

Refer Figure 1.1





**STRATEGIES AND POLICIES**

A critical first step is the determination of accounting policies under IFRS, but have to keep in mind that conversion impacts more on accounting policies. Changes to accounting policies will affect business activities.

**PROCESSES AND WORK FLOWS**

Internal auditors will need to develop and execute a plan that takes into account the time and effort for the business units to update documentation and then revise their own test plans responsive to the changes in policies, procedures and controls.

**PEOPLE AND CAPABILITIES**

Internal audit departments will need to access or “borrow” people with requisite skills in order to execute their plans. From a management perspective, it is possible that more senior financial personnel will be exercising judgment than before, and there are attendant risks on the segregation of duties front.

**COMMUNICATIONS, AWARENESS AND TRAINING**

Internal audit should plan and execute in a way that enables

timely communication of issues with an IFRS conversion for internal and external time lines.

**DATA, INFORMATION AND REPORTING**

Internal audit will need to build plans that respond to changes in the design and testing needs, which come from changing sources of data and information flows.

**SYSTEMS AND TECHNOLOGY ENABLEMENT**

Internal Audit and Information Systems Audit groups will need to be able to react to changes in the extent to which data passes through systems and pay special attention to IT change management protocols in the year(s) of conversion.

Internal audit is always important to have a clear picture of the financial health of the organization. In economic downturns and tight credit markets, it is even more important. Ledgers and internal reporting that accurately reflect the financial information enable managers to make better decisions.

**WHAT BENEFITS DOES INTERNAL AUDIT PROVIDES FOR IFRS READINESS ?**

Refer Table 1.2

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| Deliverable /assessment  | Value proposition   |
|--|---|
| <b>Project approach</b><br>Report on overall project plan and adequacy.<br>Gap analysis for the overall plan (not accounting).   | Highlight significant project risks if not addressed in the plan.<br>Provide management with time react<br>Provide partner in addressing project gaps   |
| <b>Governance and oversight</b><br>Assess initial critical decision making process.<br>Assess adequacy of governance and oversight.<br>Review initial financial statement impact.  | Ensure adequate oversight of project<br>Establish budget expectations<br>Opportunities to streamline costs (e.g. pilot conversion, internal vs. external resources)   |
| <b>Operational implications</b><br>Assess current technical capabilities.<br>Assess operational impacts on systems and internal processes.<br>Assess financial reporting process changes.<br>Review plan to address disclosure considerations. | Highlight technical skills gaps<br>Highlight significant risks to operations<br>Highlight significant change management issues<br>Recommend leading practices for implementation of system and policy changes(e.g. training and communication)<br>Highlight significant disclosure requirements |

**AUDITING OF IFRS FINANCIAL STATEMENT**

When auditing is done by following IAS, it consists of various procedures while the entity is looking for IFRS convergence then the normal procedures changes and this change we consider to be the role of change in auditing. In this case two sets of accounting principles are to be followed.

IFRS expects an entity to prepare its opening IFRS statement of financial position by following certain conditions. They are as follows :

- Recognize all the assets and liabilities whose recognition is required by IFRS.
- Not recognize items as assets or liabilities if IFRS do not permit such reorganization
- Reclassify the items that is recognized in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with IFRS
- Apply IFRSs in measuring all recognized assets and liabilities

IFRS provides certain exception in a specific case when the cost of complying would exceed the benefits of the user of the financial statement. The retrospective application is prohibited in IFRS. The disclosure which states about the entities effects of transition from GAAP to IFRS should be provided.

**IFRS CONVERSION - INTERNAL AUDIT CONSIDERATIONS**

IFRS conversion has an impact on the various fields of the business environment. They are as follows :

**IMPACT ON RISK MANAGEMENT EFFORT**

- Risk profile may change
- Revisit risk prioritization
- IFRS project risks and controls

**IMPACT ON THE INTERNAL AUDIT**

- Mandates from audit committee

- Attention to high risk

**IMPACT ON THE EFFICIENCY AND EFFECTIVENESS**

- Impacts beyond financial reporting.
- Change in the control environment.

**IMPACT ON THE PROJECT GOVERNANCE**

- Objectives, activities, deliverables and time lines are met.
- Effective change management effort

**IMPACT ON THE KEY PROCESS**

- Financial statement close process
- Manual journal entry process
- Accounting policy change process

**OTHER CONSIDERATIONS**

- Extension disclosure impact the disclosure committee process
- Impact on the control environment and entity level control
- Shifting risk profile for some accounts, assertions and disclosures
- Timing of implementing process, system and control changes
- Combination of controls and evaluation methods and strategies

**POSSIBLE AREAS OF FOCUS FOR INTERNAL AUDIT****BUSINESS PROCESS EVALUATION**

- Serve as a process risk and control advisor on key processes
- Measure control effectiveness in light of business process additions, deletions, changes
- Audit IT system changes and evaluate the ability to automate and control IT-dependent areas

#### **CONVERSION PROGRAM MONITORING**

- Identify and monitor IFRS conversion program risks
- Monitor conversion program efficiency and effectiveness
- Evaluate IFRS leadership and implementation teams in terms of preparation, readiness, resources and training

#### **RISK MANAGEMENT**

- Be the eyes and ears of the audit committee
- Monitor changes to the overall company's risk profile
- Re-prioritize audit focus, as appropriate, given the demands of conversion
- Monitor IFRS conversion impact on internal controls
- Monitor IFRS conversion program impact on going major company programs and implementations

#### **COMMUNICATION/EDUCATION/TRAINING**

- Educate the audit committee on risk and control impact on the IFRS conversion.
- Educate internal audit practitioners on IFRS influenced process changes and audit implications including documentation, testing and reporting.

#### **CONCLUSION**

The recent move towards IFRS in over 100 countries is one of the most significant regulatory changes in accounting history. The study provides rare evidence on the economic consequences of forcing firms to change an entire set of accounting and disclosure standards. Irrespective of various challenges, adoption of IFRS in India has significantly changed the contents of corporate financial statements resulted in more refined measurements of performance and state of affairs, and enhanced disclosures leading to greater transparency. In this context, the role of Indian accounting standards, which are becoming closer to IFRS, has assumed a great significance from the point of view of global financial reporting. Companies will find comfort in using accounting standards converged with IFRS if their accountants, auditors,

shareholders and other stakeholders along with the rating agencies and investment analysts are conversant with such new standards. It is true that during the transition period some problems may have to be faced by any of the aforesaid persons due to lack of adequate knowledge and experience. Therefore internal auditors should be there to assist the companies to challenge the process and make sure that they are doing everything properly in order to move towards with such a significant project. Thus companies and the internal auditors should together need a clear understanding of applicability, end requirements and implications of the IFRS on the systems and processes and the emergence of any critical business issues.