Chapter (4)

The Professional and Ethical Factors and Corporate Governance

4-1. Introduction:

A number of studies and reports which were made in the wake of collapses and financial crises resulting from cases of financial and administrative corruption in a lot of international companies over the past years have exposed the failure of those companies in the reporting process, particularly the financial reports. In this regard, (Spivey 2004:310) notes that there are many issues of concern which are worthy of debate: perhaps, the most notable of such issues, as he puts it, is the level of credibility vested in accounting and auditing firms and the quality of professional standards on which they are grounded, as well as the quality of reports prepared by the companies concerned, particularly the financial reports.

Transparency and dissemination of financial and non-financial information are considered among the reasons that led to a crisis of confidence which affected the boards of directors, the executive departments and auditors in companies. A statistical study conducted in the United States of America has shown that two out of five investors in the financial markets believe that the first problem in this crisis of confidence is the disappearance of integrity apart from the inefficiency of management and poor control compared to the problems arising from the volatility of financial markets.

Based on the above, Principle 5 of the principles of corporate governance issued by OECD regarding disclosure, transparency and internal and external audit, has indicated that information should be prepared and disclosed in accordance with high quality financial and accounting standards. Besides, Principle 6 has implied that the board of directors should guarantee and ensure the honesty and integrity of the accounts of the company and the systems of financial reporting, including independent audit, and that there are suitable monitoring systems in place, particularly the systems for risk management, financial and operational control, and compliance with the law and relevant criteria, as well as control of communication and disclosure (OECD, 2004).

In light of the above, this chapter deals with the professional and ethical requirements that influence corporate governance in four main axes:

1. Professional factors related to International Accounting Standards.
2. Professional factors related to International Auditing Standards.
3. Professional factors related to Internal Auditing Standards.
4. Professional factors related to rules of ethical conduct for accountants.

4-2. Professional Factors Related to International Accounting Standards:

Accounting and auditing are closely linked with governance both on a professional level and at the theoretical level. Obviously, accounting and auditing are among the scientific and professional fields that greatly influence and get influenced by the principles and procedures of governance since the principles and procedures of governance cannot be effectively implemented and bear fruit without the support of accounting and auditing profession. Besides, the principles and procedures of governance play a major role in the development of accounting and auditing profession. Studies conducted on this area have confirmed this relationship, and have indicated the following (Hellmann, et al. 2010:108-110):

1. The need for the accounting profession to play a prominent role in the study of the phenomenon of corporate governance within the Accounting Studies. By means of the output of this profession it becomes possible to measure and report the results of the company’s business and achieve effective delivery of these results to all parties benefiting from them, either external or internal, in a fair and balanced way. In the end, this will ultimately meet the requirements of the application of the principles of governance.

2. Accountants see that the application of the phenomenon of corporate governance will influence the degree and level of disclosure of the financial and administrative statements of the company. This is a confirmation that disclosure and transparency, and the phenomenon of corporate governance are two sides of one coin, influencing as well as getting influenced by each other. If disclosure is one of the most important principles of governance, the framework of governance procedures of companies should realize disclosure in a manner that is consistent with the quality standards of accounting and finance (Marc , G& Luc, R 2008:169).

3. The power of corporate governance influences the development of a strategic review. It is through the effective implementation of the supervision function and the adoption of a clear strategic perspective that the effectiveness of control is confirmed and, hereby, the risk of audit is reduced. This leads to a more effective and efficient review and, thus, can influence the nature, timing and scope of the audit.
4. There is a close link between the strength of corporate governance mechanisms associated with the references and the quality of financial reporting and the effectiveness of the review process.

With regard to the importance of adopting international accounting standards in Yemen, I refer to what has been stated by Mr. Robert Garnett, an expert with the World, and a member of the Board of Directors of International Accounting Standards Board (IASB) and Chairman of the International Financial Reporting Interpretations Committee (IFRIC), that the adoption of International Financial Reporting Standards would open the door to attracting more direct investment to countries that adopt these standards. He added that many countries (about 100 countries) that use international standards have become more attractive to global investors than ever, which enhanced the economic growth and job creation. Mr. Garnett praised India, which is witnessing significant growth in investments and is moving towards adoption of international standards (IFRS).

4-2-1. Disclosure Rules and Transparency According to International Accounting Standards:

Given the importance of presentation and disclosure to users of financial statements, the International Accounting Standards (IAS) issued by the International Accounting Standards Committee (IASC) have paid great attention to the considerations of presentation and disclosure of accounting information. Each standard of International Accounting Standards identifies some disclosure required by any standard. The most important international accounting standards dealing with disclosure are International Accounting Standard 1 (Presentation of Financial Statements), International Accounting Standard 24 (Related Party Disclosures), International Accounting Standard 30, the International Standard 7, i.e. for the preparation of financial reports – Financial Instruments: Disclosures, which replaced the International Accounting Standard 30 and part of the International Accounting Standard 32, especially on disclosures (Greuning & Bratanović 2009:348).

4-2-1-1. Disclosure Policies as per the International Accounting Standard (1):

Presentation of Financial Statements:

Content of financial statements: The entire group consists of the financial statements in accordance with International Accounting Standard (1) Presentation of Financial Statements, as follows:

1 - Balance Sheet
2 - Statement of comprehensive income
3 - Statement of changes in equity
4 - Statement of cash flows
5 – Notes (attached to financial statements and are considered a part of them).

That is to say, the necessary information should be informed to enable the beneficiaries to assess the performance of the enterprise and its ability to achieve their goals – being investors or lenders or other beneficiaries.

1. List of financial position (balance sheet):

The first criterion of International Accounting Standards requires a distinction between assets and current and non-traded liabilities. This classification provides useful information by highlighting the net assets traded down as working capital from those used in long-term processes. It is also useful in clarifying the assets expected to be realized within the current operational session and the commitments payable during the same period. This criterion excludes financial institutions, since they can present assets and liabilities according to the degree of liquidity in an ascending or descending order, as this provides adequate information that is more reliable than the classification of traded and non-traded.

This standard also identifies the information to be displayed in the balance sheet as a minimum, which includes the following paragraphs:

Information to be presented in the statement of financial position as a minimum; the statement of financial position shall include line items that present the following amounts:

a) Property, plant and equipment;
b) Investment property;
c) Intangible assets;
d) Financial assets;
e) Investments accounted for using the equity method;
f) Biological assets;
g) Inventories;
h) Trade and other receivables;
i) Cash and cash equivalents;
j) The total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
k) Trade and other payables;
l) Provisions;
m) Financial liabilities;
n) Liabilities and assets for current tax, as defined in IAS 12 Income Taxes;
o) Deferred tax liabilities and deferred tax assets;
p) Liabilities included in disposal groups classified as held for sale
q) Non-controlling interests, presented within equity; and
r) Issued capital and reserves attributable to owners of the parent.

An entity shall disclose the following, either in the statement of financial position or the statement of changes in equity, or in the notes:

a) For each class of share capital:
   i. The number of shares authorized;
   ii. The number of shares issued and fully paid, and issued but not fully paid;
   iii. Par value per share, or that the shares have no par value;
   iv. A reconciliation of the number of shares outstanding at the beginning and at the end of the period;
   v. The rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
   vi. Shares in the entity held by the entity or by its subsidiaries or associates; and
   vii. Shares reserved for issue under options and contracts for the sale of shares, including terms and amounts; and

b) A description of the nature and purpose of each reserve within equity.

c) The amount of dividends distributed.

2. **Statement of comprehensive income:**

Information to be presented in the statement of comprehensive income as a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period:

a. Revenue;
b. Finance costs;
c. Share of the profit or loss of associates and joint ventures accounted for using the equity method;
d. Tax expense;
e. A single amount comprising the total of:
   i. The post-tax profit or loss of discontinued operations and
   ii. The post-tax gain or loss recognized on the measurement to fair value less costs
       to sell or on the disposal of the assets or disposal group(s) constituting the
       discontinued operation;

f. Profit or loss;

g. Each component of other comprehensive income classified by nature;

h. Share of the other comprehensive income of associates and joint ventures accounted
   for using the equity method; and

i. Total comprehensive income.

j. Dividends distribution.

3. **Statement of changes in equity:**

   An entity shall present a statement of changes in equity showing in the statement:

a. Total comprehensive income for the period, showing separately the total amounts
   attributable to owners of the parent and to non-controlling interests;

b. For each component of equity, the effects of retrospective application or retrospective
   restatement recognized in accordance with IAS 8; and

c. [Deleted]

d. For each component of equity, a reconciliation between the carrying amount at the
   beginning and the end of the period, separately disclosing changes resulting from:
   i. Profit or loss;
   ii. Each item of other comprehensive income; and
   iii. Transactions with owners in their capacity as owners, showing separately
       contributions by and distributions to owners and changes in ownership interests in
       subsidiaries that do not result in a loss of control.

4. **Statement of cash flows:**

   Cash flow information provides users of financial statements with a basis to assess the
   ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize
   those cash flows. IAS 7 sets out requirements for the presentation and disclosure of cash flow
   information.

5. **Notes:**

   The notes shall:
a. Present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 117–124;
b. Disclose the information required by IFRSs that is not presented elsewhere in the financial statements; and
c. Provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

An entity normally presents notes in the following order, to assist users to understand the financial statements and to compare them with financial statements of other entities:

a. Statement of compliance with IFRSs;
b. Summary of significant accounting policies applied;
c. Supporting information for items presented in the statements of financial position and of comprehensive income, in the separate income statement (if presented), and in the statements of changes in equity and of cash flows, in the order in which each statement and each line item is presented; and
d. Other disclosures, including:
   i. Contingent liabilities and unrecognized contractual commitments, and
   ii. Non-financial disclosures, e.g. the entity’s financial risk management objectives and policies.

There is a set of general considerations that govern the presentation of financial statements as stated in the Accounting Standard (1), which are as follows:

1. **Fair presentation:** the standard requires that financial statements are presented in a fair and clear way with regard to the institution’s financial position and performance as well as its financial flows. Fair presentation requires an authentic representation of the impact of transactions and other events and circumstances.

2. **Sustainability of the business:** When preparing financial statements the standard is required of the administration to conduct an assessment of the entity’s ability to continue business as a sustainable entity.

3. **Accrual basis of accounting:** IAS 1 requires that the sustainable business entity should prepare its financial statements, except for cash flow information under the accrual basis of accounting.
4. **Presentation Stability**: International Accounting Standard 1 stipulates that a display style and classification of the paragraphs are retained in the financial statements from period to another.

5. **Materiality and assembly**: Each material item should be displayed separately in the financial statements, and non-material items should be assembled with the amounts of similar nature or function. There is no need to display them independently.

6. **Clearing**: International Accounting Standard 1 requires that clearing between assets and liabilities should be made only if the clearing is required or permitted by another International Accounting Standard. Besides, clearing of items of income and expenses should be done when and only when the following is realized: if an International Accounting Standard requires or permits that, or if the profits and losses and expenses relating thereto and arising thereof or from similar operations or events that are not material; and these amounts must be collected.

4-2-1-2. **Disclosure policies in accordance with International Accounting Standard 24:**

**Related Party Disclosures:**

IAS 24 requires, as required by legislation in many countries, the provision of financial statements disclosures about specific groups of related parties. In particular, attention has to be paid to processes with the directors of the facility, especially with reference to remuneration and borrowing, because of the credit relationship with the facility. In addition, these should be disclosed in the financial statements, the disclosure of important processes between group’s companies, investments and stocks with the group and associated companies and managers. Besides, International Accounting Standard 27 requires the consolidated financial statements and the accounts of investments in subsidiaries. IAS 28 (Accounts for Investments in Associate Facilities) requires the disclosure of the list of subsidiary and associate facilities. IAS 8 (Net Profit or Loss for the Period and Basic Errors and Changes in Accounting Policies) requires disclosure of extraordinary items and items of income and expenses within profit or loss as normal activities that are of the size or nature or frequency so that they are disclosed properly to explain the performance of the enterprise for the period.

Therefore, when a bank enters in operations with related parties, it is appropriate to disclose the nature of the relationship, types of operations and elements of the processes necessary to understand the financial statements of the bank. The elements that must be usually disclosed under IAS 24 (Disclosure of Related Parties) include the bank’s lending policy
towards the related parties. With regard to operations with the related parties the amount or percentage of the following should be disclosed:

1) All of the loans, advances, deposits, acceptances and bills of exchange; here disclosures could include the total amounts existing at the beginning and end of the period, as well as advances, deposits, payments and other changes during the period.

2) All basic kinds of income, interest expense, and commissions paid.

3) The amount of expenses recognized during the period of losses on loans and advances, and the amount allocated as of the balance sheet.

4) The non-cancellable commitments, and contingencies and commitments arising from off-balance sheet items.

**4-2-1-3. Disclosure policies in accordance with International Financial Reporting Standard IFRS7 (Financial Instruments: Disclosures):**

The International Standard for financial reporting 7 has replaced IAS 30 and part of the IAS32 regarding disclosure; the requirements of the standard are briefly as follows:

1. **Disclosure of accounting policies for a list of financial position (balance sheet):**

   Paragraph (8) of the standard indicated that carrying amounts of each of the following categories shall be disclosed either in the statement of financial position or in the notes:
   
   a. Financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading;
   
   b. Held-to-maturity investments;
   
   c. Loans and receivables;
   
   d. Available-for-sale financial assets;
   
   e. Financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading;
   
   f. Financial liabilities measured at amortized cost.

**Financial assets or financial liabilities at fair value through profit or loss:**

Paragraph (9) of the standard states that if the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it shall disclose:
a. The maximum exposure to *credit risk* (a) of the loan or receivable (or group of loans or receivables) at the end of the reporting period.

b. The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

c. The amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:
   
   i. As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or

   ii. Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset. Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

**Reclassification:**

Paragraph (11) of the standard indicates that if the entity has reclassified a financial asset as one measured:

(a) At cost or amortized cost, rather than at fair value; or

(b) At fair value, rather than at cost or amortized cost,

It shall disclose the amount reclassified into and out of each category and the reason for that reclassification.

Paragraph (11) of the standard indicates that if the entity has reclassified a financial asset out of the fair value through profit or loss category or out of the available-for-sale category, it shall disclose:

a. The amount reclassified into and out of each category;

b. For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;
c. If a financial asset was reclassified, the rare situation, and the facts and circumstances indicating that the situation was rare;
d. for the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognized in profit or loss or other comprehensive income in that reporting period and in the previous reporting period;
e. for each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognized in profit or loss or other comprehensive income if the financial asset had not been reclassified, and the gain, loss, income and expense recognized in profit or loss; and
f. The effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

**Derecognition:**

An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition. The entity shall disclose for each class of such financial assets:

a) The nature of the assets;
b) The nature of the risks and rewards of ownership to which the entity remains exposed;
c) When the entity continues to recognize all of the assets, the carrying amounts of the assets and of the associated liabilities; and
d) When the entity continues to recognize the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.

**Collateral:**

1- An entity shall disclose:

a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified; and
b) The terms and conditions relating to its pledge.
2- When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
   a) The fair value of the collateral held;
   b) The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
   c) The terms and conditions associated with its use of the collateral.

**Defaults and breaches:**

For payable loans recognized at the end of the reporting period, an entity shall disclose:
   a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
   b) The carrying amount of the loans payable in default at the end of the reporting period; and
   c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorized for issue.

**2. Statement of comprehensive income:**

**Items of income, expense, gains or losses:**

An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:
   a) Net gains or net losses on:
      i. Financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading;
      ii. Available-for-sale financial assets, showing separately the amount of gain or loss recognized in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;
      iii. Held-to-maturity investments;
      iv. Loans and receivables; and
      v. Financial liabilities measured at amortized cost;
b) Total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss;

c) Fee income and expense (other than amounts included in determining the effective interest rate) arising from:

i. Financial assets or financial liabilities that are not at fair value through profit or loss; and

ii. Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

d) Interest income on impaired financial assets accrued; and

e) The amount of any impairment loss for each class of financial asset.

3. Other disclosures:

(1) Hedge accounting:

An entity shall disclose the following separately for each type of hedge (fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):

a) A description of each type of hedge;

b) A description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and

c) The nature of the risks being hedged.

For cash flow hedges, an entity shall disclose:

a) The periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

b) A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

c) The amount that was recognized in other comprehensive income during the period;

d) The amount that was reclassified from equity to profit or loss for the period, showing the amount included in each line item in the statement of comprehensive income; and

e) The amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.

An entity shall disclose separately:
a) In fair value hedges, gains or losses:
   i. On the hedging instrument; and
   ii. On the hedged item attributable to the hedged risk.

b) The ineffectiveness recognized in profit or loss that arises from cash flow hedges; and

c) The ineffectiveness recognized in profit or loss that arises from hedges of net investments in foreign operations.

(2) Fair value:

In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.

An entity shall disclose:

(a) The methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.

(b) Whether fair values are determined, in whole or in part, directly by reference to published price quotations in an active market or are estimated using a valuation technique.

(c) Whether the fair values recognized or disclosed in the financial statements are determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (i.e. without modification or repackaging) and not based on available observable market data. For fair values that are recognized in the financial statements, if changing one or more of those assumptions to reasonably possible alternative assumptions would change fair value significantly, the entity shall state this fact and disclose the effect of those changes. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognized in other comprehensive income, total equity.

(d) If (c) applies, the total amount of the change in fair value estimated using such a valuation technique that was recognized in profit or loss during the period.
(3) Credit risk:

- **An entity shall disclose by class of financial instrument:**
  a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g. netting agreements that do not qualify for offset in accordance with IAS 32);
  b) In respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;
  c) Information about the credit quality of financial assets that are neither past due nor impaired; and
  d) The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

- **Financial assets that are either past due or impaired:**
  An entity shall disclose by class of financial asset:
  a) An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired;
  b) An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired; and
  c) For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

- **Collateral and other credit enhancements obtained:**
  When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g. guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose:
  a) The nature and carrying amount of the assets obtained; and
  b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

(4) Liquidity risk
An entity shall disclose:

a) A maturity analysis for financial liabilities that shows the remaining contractual maturities; and

b) A description of how it manages the liquidity risk inherent in (a).

(5) Market risk

Sensitivity analysis:

Unless an entity complies with paragraph 41, it shall disclose:

a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

b) The methods and assumptions used in preparing the sensitivity analysis; and

c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.

4-2-1-4. The Role of the Auditor in Disclosure of Financial Reports:

A fair presentation is considered one of the factors influencing the benefit of accounting information, and its reliability on the part of users of financial statements; and for the following reasons (Abu Zer, 2006):

A. To provide objectivity in the information derived from financial statements, as fair presentation requires the use of accounting methods based on international accounting standards.

B. To reduce personal bias when choosing certain accounting methods, thereby prevent or reduce intentional or unintentional errors that may affect the significance of the financial statements.

C. To increase the benefit of the accounting information from the viewpoint of decision makers, as fair presentation increases the reliability of accounting data as a tool for decision-making.

D. To increase the relative importance of the profession of accounting and auditing for the management of the facility, employees, investors and stakeholders.

E. To achieve the main objective of the function of the auditor as a neutral arbiter between the various parties associated with the facility.
It could be argued that fair presentation of financial statements is beset with many difficulties. Although there is a possibility of using accounting standards as a tool to achieve homogeneity of treatment of accounting between the various establishments, the application of these standards requires the following:

A. Relying on personal judgment, due to economic as well as internal and external environmental changes, and the difficulty of achieving uniformity in different situations that occur during practice, leading to a different application of accounting policies from the facility to another.

B. The adoption of appropriate timing for presentation of financial statements to external data and audit procedures, in addition to the integration and efficiency of the accounting system and the efficiency of workers in the financial management.

C. The speed of development in the field of business, hence the lack of appropriate standards for the practical application.

There is no doubt, these difficulties increase the complexity of the audit procedures, since the adoption of the financial statements by the auditor is one of the important pillars to ensure fair presentation, and therefore the duties of the auditor on the assessment of fair presentation is as follows:

A. Verification of the commitment to the establishment to accounting standards and domestic legislation so as to reduce personal bias on one hand, and ensure harmonization of accounting treatments on the level of activity on the other hand.

B. Verification of the extent of personal judgment resorted to by the management of the business (accounting policies).

C. Verification of the accounting estimates adopted by management when preparing the financial statements and their impact on the significance of these data.

D. Auditing of additional reports.

E. Auditing quantitative and statistical reports.

F. Speed of completion of audit procedures through the planning and implementation of audit procedures in a timely manner. This requires the auditor to include audit programs and procedures necessary to verify compliance with international accounting standards.
4-3. Professional Factors Related to International Standards on Auditing:

The financial scandals that have taken place for corporate America with the United States from developed countries and led to the formation of accounting standards. The development has raised many important questions on the topic of corporate governance. It is time to take this into account and re-examine the fundamental and essential relationship between the external auditor, the company’s management and the board of directors (Cohen, et al., 2002:577). The clarification of the modern responsibility of external auditor and the issues and brought him, as a result of their involvement in issues of professional away from professional conduct that must be committed, and the best evidence that what happened to the company of Arthur Anderson lost in 1999 amount of U.S. $ 90 million for the condemned In the case of a loss company (Colonial Realty), amounting to U.S. $ 300 million, not to mention the scandal of a company (Enron) and others, as a result of this collapse in the American giant companies and other global company such as (parmalat), On the local level, accounting and auditing profession is still a formal, despite the emergence of many interpretations, accounting and economic and financial developments, which became the jurisprudence of personal and interpersonal larger role in the formation of financial reports according to size and demand without taking into account the norms and principles of accounting, auditing, ethics and professional conduct, so there is doubt and not convinced by the users of financial statements of the role Carried out by the External Auditor, which requires addressing this situation and the need for auditors to prove their independence and impartiality and full adherence to professional ethics and behavior of the application of the spirit of the law.

Having highlighted the financial scandals and accounting of modern corporate giants in the United States such as Enron, and other many questions about the credibility of corporate governance and its relationship to accounting and auditing profession, the manipulation and fraud that took place in these companies and the complicity of the external auditors have a negative impact on investor and the citizen and the national economy in general, Which lose confidence in the institutions and external auditors, which requires re-establish confidence in the relationship between auditors and companies and economic institutions and the management of these companies, especially the Governing Council, and improve the conduct and ethics and, if this is what happens in the United States and the developed countries, which issued all legislation, standards and behaviours Organization of accounting and auditing
profession, what can we say about the third world countries in general and our country in particular.

International Audit Standards have included ISA 240 (The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements), ISA 510 (Going Concern), ISA 260 (Communication with Those Charged with Governance), and ISA 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management) in order to enhance the role and responsibilities of the management and the auditor. Based on the above, the research now presents the duties and responsibilities of the management and the auditor regarding the above issues, as follows:

4-3-1. The duties and responsibilities of management and the auditor on fraud.

4-3-2. The duties and responsibilities of management and the auditor on communication with Those Charged with Governance.

4-3-3. The duties and responsibilities of management and the auditor on Going Concern.

4-3-4. The duties and responsibilities of auditor on Communicating Deficiencies in Internal Control to with Those Charged with Governance.

4-3-1. The Duties and Responsibilities of Management and the Auditor on Fraud:

A survey conducted in the United States of America in 1974 has revealed that 66% of investors believe that the most important function of accounting companies and firms is the discovery of fraud and error. A study (Humphrey, et. al) concluded that 43% of the accountants, 60% of the chartered accountants, and 62% of the financial managers believe that it is the duty of auditors to detect fraud. Contrastively, the ratio in favour of this view in the sample of other users of financial statements, representing investors, bankers and financial journalists, stood at 86%. The researchers have commented on this result by saying that “the subject of fraud has always remained a source of stress for the heart over the past years, and in many discussions of the gap of expectation” (Humphrey, et. Al., 1993:400).

In a study, Porter (date) pointed out that 91% of the chartered accountants, 99% of the officials specialize in the companies that are audited, and 98% of the users of financial statements who are specialists in financial matters assert that the obligatory task of chartered accountants is the discovery of deliberate distortion of financial information. They also see that one of the functions of auditors is the reservation in the audit report of the deliberate distortion of financial information – by a total of 76% (Porter, 1993:60).
The International Auditing and Assurance Standards Board (IAASB) issued International Standard No. 240: The Auditor’s Responsibilities Relating to Fraud and Error in an Audit of Financial Statements. This standard focuses on the responsibilities of the auditor regarding fraud and error, where the main responsibility is to prevent and detect fraud by those charged with supervision and management of the bank. So, the standard stressed that the auditor should – while planning and performing audit procedures and evaluating and reporting results – take into account the risk of material distortions in the financial statements resulting from fraud and error. Based on the above, the duties and responsibilities of management and auditor regarding fraud can be illustrated as follows:

4-3-1-1. The Duties and Responsibilities of Management on Fraud:

ISA 240 indicates that the primary responsibility to prevent and detect error and fraud is shouldered by each person in charge of supervision and its management. The responsibilities of each person in charge of supervision and its management can vary depending on the facility and from one country to another. The management (under the supervision of individuals in charge of monitoring) needs to develop the correct method, create a culture of honesty and high morals and maintain them, and establish appropriate regulatory systems to prevent and detect error and fraud within the enterprise.

The responsibility of the persons in charge of supervision at the facility is to ensure the security of the accounting systems and the financial report of the facility through supervising the management. They should also ensure that appropriate control systems have been placed in the correct or appropriate position, including those who are subsumed under risk, financial control, and compliance with the law. Besides, the responsibility of managing the business creates a control environment and maintains policies and procedures to help achieve the goal of ensuring orderly and efficient conduct of the business to the furthest extent possible. Such responsibility includes the implementation and security of the operational process of the accounting systems and internal controls which are designed to prevent and detect error and fraud – such systems reduce the risk of distortion, but do not exclude it entirely, regardless of whether they have caused the error or fraud, hence, management takes on the responsibility of any residual risk.

Those in charge of supervision at the facility also shoulder the responsibility for overseeing the systems of risk follow-up and financial control and the extent of its compliance with the law. In many countries, company supervision practices have advanced well, and the
persons in charge of supervision perform an active role in overseeing how the management fulfils its responsibilities. In such circumstances auditors are encouraged to try to obtain the views of those charged with supervision on the adequacy of the used accounting systems and internal controls to prevent and detect fraud and error, the probable risk of fraud and error, and the efficiency and integrity of management. Such enquiries may bring about, for example, recognition of the vulnerability of the entity to fraud. The auditor may have the opportunity to obtain the views of persons in charge of supervision, for example, during a meeting with them to discuss the general style and overall scope of the audit process: as such a discussion could make it possible for persons charged with the supervision opportunity to raise important issues in front of auditors.

Because the responsibilities of persons in charge of supervision and management may vary from one facility to another and from one country to another, it is necessary for the auditor to understand the nature of these responsibilities at the facility in order to ensure that the inquiries and communications described above may be directed to the appropriate individuals. In addition to that, following the management’s inquiries as described in the paragraphs 22-27 of the Standard, the auditor must take into account whether there are any issues concerning control that will be discussed with those charged with supervision of the business. These might include the following example:

A. Concerns regarding the nature, extent and frequency of management’s assessment of accounting systems and controls used to prevent and detect fraud and error, as well as assessment of the risk resulting from the possibility of distortion of financial statements.

B. Management’s lack of addressing material weaknesses in internal control systems identified during the previous audit process.

C. Auditor’s evaluation of the established regulatory environment, including questions related to management efficiency and integrity.

D. The impact of any issues, such as those described above, on the general style and overall scope of the audit process, including the additional measures that the auditor may require to take.

4-3-1-2. The Duties and Responsibilities of the Auditor on Fraud:

ISA 240 indicates that the objective of auditing financial statements as described in ISA 200 (Objective and general principles governing the audit of financial statements) is to enable the auditor to give an opinion about whether the financial statements are prepared in all
material respects in accordance with a framework specified for the submission of financial statements, and that the auditing process, which is conducted in accordance with International Auditing Standards, is designed to provide reasonable assurance that the financial statements, if taken as a whole, are free of any material distortion. Despite the fact that the audit process that was performed may serve as a blocker, the auditor does not assume responsibility for preventing fraud or error, and cannot be so, because of limitations inherent in the process of auditing, which include the following:

A. The auditor cannot obtain an absolute assurance that there will be discovery of material misrepresentations in the financial statements due to the limitations inherent in the audit process. There are risks that cannot be avoided, i.e. some of the material misrepresentations in the financial statements will not be detected even if the audit is conducted and planned in accordance with International Standards of Auditing. Besides, the audit process cannot guarantee that it will discover all the material misrepresentations for a number of factors, such as the use of self-government, the use of the test, limitations inherent in the internal control system, and the fact that most of the evidence available for the auditor is persuasive in nature rather than circumstantial. Due to these reasons the auditor can only obtain reasonable assurance that material misstatements will be detected in the financial statements.

B. The risk of not detecting material misrepresentation resulting from fraud is greater than the risk of non-discovery of material misrepresentation resulting from error. This is because fraud may include elaborate and carefully organized plans in order to hide the fraud, such as forging and intentional concealment of specific transactions recording or intentional misrepresentation meant to beguile the auditor. Such concealment attempts may be more difficult to detect if accompanied by collusion – collusion may lead the auditor to believe that the available evidence in front of him/her is convincing when it is in fact fake. The ability of the auditor to detect fraud in such cases depends on the perpetrator’s skill at such fraud and the repetition and extent of manipulation, as well as the relative size of the sums that has been manipulated, and the administrative status of the persons involved. Effective audit procedures may become ineffective in error detection when it comes to the disclosure of fraud.

C. In addition, the risks faced by the auditor as a result of the failure to discover material distortion resulting from management’s fraud are greater than the risks of the non-
discovery of distortion caused by staff fraud. This is because the persons in charge of supervision and management are often in a position that presumes honesty and allows them to pass over official control procedures. There are certain levels of management at which workers can be at a position in which they can override control procedures designed to prevent likely similar fraud by other workers: for example, they may issue directives to their subordinates to register transactions in a wrong way or hide them. Here, due to the position of management and the extent of power it has in the facility, the management is able either to issue instructions for employees to do something, or ask for their help in the fraud with or without their knowledge.

D. The auditor’s opinion regarding the financial statements depends on the idea of obtaining reasonable assurance. Therefore, the auditor does not guarantee in the audit process to discover any material misrepresentations, whether due to fraud or error. Consequently, the discovery of the existence of material misrepresentations in the financial statements resulting from fraud or error does not itself imply the following:

- Failure to obtain reasonable assurance.
- Inappropriate planning, performance or personal judgement.
- Lack of professional competence or diligence.
- Failure to comply with International Standards on Auditing.

The auditor must, therefore, plan and perform the audit by assuming a position of professional uncertainty (caution) in accordance with the International Standard No. 200 (Goals and General Principles Governing the Audit of Financial Statements), paragraph (6). This position is necessary for the auditor so that s/he could make selection and evaluation properly, for example:

- Things that increase the risk of material misrepresentations in the financial statements resulting from fraud or error (for example: management features and their impact on the control environment, operating characteristics, and financial stability).
- The conditions that stir the auditor’s doubts that the financial statements have been materially misrepresented.
- Evidence obtained by the auditor (including the knowledge gained from previous audits), which raises questions about the reliability of the management’s reports (assurance).
During the planning of the audit process, the auditor must also discuss with other members of the audit team about the possibility of material misrepresentations in the financial statements of the establishment resulting from fraud or error. Such discussions within a particular facility include, for example, considering the areas where there is a greater likelihood for the occurrence of errors or how to commit fraud. On the basis of these discussions the audit team members can get a better understanding of the likelihood of material misrepresentations in the financial statements resulting from fraud or error in the areas of audit entrusted to them, and how the results of audit procedures they have done can impact on the other aspects of the audit process.

It is also possible to take decisions on matters performed by the audit team, such as specific inquiries or audit procedures, and how the results of these inquiries and actions will be shared with all auditors. Furthermore, the auditor must – when planning for the process of audit – inquire the management regarding the following:

1. Obtaining an understanding of:
   - Management’s assessment of the risk and danger of the possibility that the financial statements are materially misrepresented as a result of fraud.
   - Accounting systems and internal controls set up by management to address such risk.
2. Getting to know the management’s understanding with respect to accounting systems and internal control systems designed to prevent and detect error.
3. Determining whether management was aware of any fraud that had an impact on the establishment, or suspected a fraud case and is being investigated.
4. Determining whether the management had discovered any material errors.

The auditor must also promote his/her knowledge of the establishment’s business by making inquiries of management regarding the management’s assessment of fraud risk and the systems designed to prevent and detect it. In addition to that, the auditor should make inquiries of management with respect to accounting systems and internal control systems designed to prevent and detect errors. Since management is responsible for accounting systems and internal control systems and the preparation of financial statements, it is appropriate for the auditor to inquire the management on how they carry out such responsibilities. However, the things that could be discussed as part of these queries include the following:
1. Whether there are sites of certain subsidiary companies, sectors of business, types of transactions, account balances, or categories of financial data in which the probability of error is high, or where there are elements of fraud, and how the management treats them.

2. The performance of internal audit of the facility, and whether this audit has discovered the existence of fraud or any serious weaknesses in internal control system.

3. The method by which the management delivers its opinion to staff on responsible business practices and ethical conduct through ethical policies or rules of conduct.

In addition to the above, it is important for the auditor to understand the design of accounting systems and internal control in the facility. While designing such systems, the management passes resolutions based on information on the nature and extent of control procedures chosen for implementation as well as the nature and extent of the risks of the choice. As a result of the auditor’s inquiries of the management, s/he may be aware, for example, that the management has consciously made a choice and accepted the risk related to the lack of segregation of duties. Moreover, the information gleaned from these inquiries may be useful in identifying the risk factors of fraud that may affect the assessment of the auditor to the risk that financial statements have been containing a material misrepresentation caused by this fraud.

It is also necessary for the auditor to inquire about the management’s knowledge of the fraud that affected the business, and the suspected fraud being investigated, and the materials errors discovered. Such inquiries may indicate possible weaknesses of control measure and, if some errors are found to happen in certain areas alternately, for example, such inquiries may indicate that control procedures function effectively because anomalies are identified and investigated immediately.

Although the inquiries of the auditor of management may provide useful information regarding the risk of material misrepresentations in the financial statements resulting from staff fraud, such inquiries are not likely to provide him/her with useful information regarding the risks of material misrepresentations in the financial statements resulting from management fraud; accordingly, the auditor’s follow-up of fraud risk factors, as discussed in paragraph (39) of the ISA 240, is particularly suitable with regard to fraud committed by management.
In addition to the above, Standard No. 240 has indicated according to paragraphs 48-49 that the auditor must assess misrepresentations and act upon them, elaborating their impact on his/her report as follows:

1. When the auditor affirms, or is unable to conclude, whether the financial statements have been misrepresented materially as a result of fraud or error, s/he should consider the implications of the audit process and provide the International Standard No. 320 (audit materiality), paragraphs (12-16), and the Standard No. 700, (The Auditor’s Report on Financial Statements) paragraphs (36-46) – guidelines on the evaluation of misrepresentations and acting on them.

2. The auditor should document the risk factors of fraud identified as being present during the evaluation process carried out by the auditor (see paragraph 32). Besides, s/he should document his/her reaction with respect to any of these factors (see paragraph 39). If, during the process of auditing, fraud risk factors have been identified and the auditor believes that it is necessary to take additional audit procedures, the auditor should document the existence of such factors and the reaction towards it.

3. ISA No. (230) (authentication) requires of the auditor to document the important issues to provide evidence to support the auditor’s opinion. This standard states that the working papers must include the proof of the auditor on all important issues which require the issuance of a ruling around, along with his/her conclusion on that. Because of the importance of fraud risk factors in risk assessment of inherited risks of material misrepresentations or the risk of controlling them, the auditor should document fraud factors that have been identified and the appropriate reaction of the auditor.

Therefore, Paragraphs 51-55 of the standard indicate that the auditor must obtain acknowledgments from management as to:

1. Accept responsibility for the development and implementation of accounting systems and internal controls designed to prevent and detect fraud and error.
2. Believe that the effects of uncorrected misstatements in the financial statements collected by the auditor during the audit are not material, individually and collectively, with respect to the financial statements as a whole – a summary of these items with the written representations must be attached.
3. Inform the auditor of all significant facts relating to the existence of any fraud or doubt about the existence of fraud known to management and is likely to have an impact on the facility.

4. Disclose to the auditor on the results of its assessment of the risk that the financial statements may have been materially misrepresented as a result of fraud.

In addition to recognition of the management responsibility for financial statements, it is also important to recognize its responsibility for accounting systems and internal controls designed to prevent or detect fraud or error.

Because management is responsible for the amendment of financial statements to correct material misrepresentations, it is important for the auditor to get written representation from the management that any misstatements uncorrected resulting either from fraud or error are in the opinion of management to be not material, individually or collectively. These representations are no substitute for the need to obtain sufficient and appropriate evidence to the audit process. In some cases, the management may not consider as misrepresentations the uncorrected errors in the financial statements collected by the auditor during its audit process, and for this reason the management may wish to add certain words to written representations, such as: “We do not agree that items ... and ... constitute misstatements because (with the reasons)”.

Paragraphs 56-68 have included the responsibilities and duties of the auditor on the reporting of misrepresentations caused by error and fraud, and weaknesses in internal control, and also reporting to regulatory and executive authorities in the following cases:

1. When the auditor determines the presence of misrepresentation caused by fraud, or suspected fraud or error, s/he must take into account the auditor’s responsibility to inform about this to the management or the persons responsible for supervision and, in some cases, the regulatory and executive authorities.

2. The reporting of the existence of misrepresentation resulting from fraud or suspected fraud or error of the appropriate level of management in a timely manner is important because it would enable the management to take action as is necessary. Determining the level of management appropriate for the delivery of this information is a question of professional judgment and is influenced by such factors as the nature, amount and frequency of the misrepresentation, fraud, or suspicion. Usually, the appropriate level of management is at least one level above the people who seem to be involved in this fraud, misrepresentation or suspicion.
3. Regarding the identification of the issues that the auditor must inform to the persons responsible for supervision, this is a matter of professional judgement and is affected by any mutual understanding between the parties with respect to the matters to be communicated, and usually include the following issues:
   - Questions related to management efficiency and fairness.
   - Fraud involving the management.
   - Other types of fraud that lead to material misstatements in the financial statements.
   - Material misrepresentations resulting from the error.
   - Misrepresentations that indicate a material weakness in internal control system, including the design and delivery of financial reports of the facility or the method of doing that.
   - Misrepresentations that may cause distortion in the financial statements in the future.

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4. If the auditor identifies a material misrepresentation due to a mistake, s/he must communicate this distortion to the appropriate level of management in a timely manner, and consider the need to submit a report thereon to the persons in charge of oversight in accordance with International Standard Number (260) (Reporting Audit Matters to the Persons Responsible for Supervision).

5. The auditor should inform the persons charged with oversight regarding uncorrected distorted data collected by the auditor during the audit process and considered by the management as not material, individually or collectively, in terms of the financial statements as a whole.

6. As indicated in Paragraph No. (54), there is no need to include uncorrected distortions reported to the persons in charge of control, i.e. distortions that are less than a certain amount.

7. If the auditor does the following:
   - identified a fraud which has either led or not led to a significant distortion in the financial statements, or
   - obtained the evidence suggesting the possibility of fraud (even if the potential effects on the financial statements are not material), the auditor must report such
matters to the appropriate management level in a timely manner, and consider the need to report on such matters to persons charged with oversight and according to ISA 260 (Communication with Those Charged with Governance).

8. When the auditor obtains evidence of the existence of fraud or the possibility of its existence, it is important to draw the attention of the appropriate management level to this issue. The auditor must do so even if the matter is considered of no significant effects (for example, if the matter related to embezzling a slight amount by a small employee at a low level in the organization of the facility). The process of determining the appropriate management level in these circumstances is affected by the possibility of collusion or involvement of a member of the management.

9. If the auditor decides that the distortion is the result of fraud, and that its impact may be material to the financial statements, or that s/he could not assess whether the impact is material, s/he must:

- discuss the matter and method to conduct further research with an appropriate or one-step higher level of management than the level of those involved, as well as with management at the highest levels.
- propose to the management, if appropriate, to consult with a legal counsel.

10. The auditor must inform the management of any material weaknesses in the internal control system relating to the prevention or detection of any fraud or error, which drew the attention of the auditor during the performance of the audit process. The auditor should also be convinced that s/he has informed the persons in charge of oversight of any aspect of material weakness in internal control system regarding the prevention or discovery of fraud which the management had drawn the attention of the auditor to, or identified by the auditor during the audit process.

11. When the auditor determines any material weaknesses in the internal control system relating to the prevention or detection of fraud or error, s/he should notify the weaknesses of these in the system of internal control to management. Due to the serious connotations of the material weaknesses in internal control system relating to the prevention or detection fraud, it is also important to draw the attention of persons in charge of oversight to these shortcomings. According to the law (Sarbanes Oxley), the auditor has to report on the efficiency of internal audit.
12. Where there is doubt about the integrity or honesty of management or those charged with oversight, the auditor usually has recourse to legal advice to assist in determining the appropriate action that should be taken.

13. The professional duty of the auditor to maintain confidentiality of client information does not usually allow informing fraud and error to another party out of the business concerned. However, the auditor’s legal responsibility differs from one country to another and, in certain circumstances, it is possible to override the duty of confidentiality through legislation or law or the courts. For example, in some countries, the auditor working at a financial institution is bound to a legal duty to inform the occurrence of fraud or material error to supervisory authorities – in such cases, the auditor may seek legal advice.

4-3-2. The Duties and Responsibilities of the Auditor’s Communication with the Management and Those Charged with Governance:

International Auditing and Assurance Standards Board (IAASB) issued International Standard No.260 (Communication with Those Charged with Governance). The objective of this standard is to provide guidance with regard to communication on matters of audit resulting from audits of financial statements between the auditor and those charged with governance. This standard does not provide guidance with regard to contacts between the auditor and parties outside the business, e.g. external supervisory or regulatory agencies. Based on the above, the nature of contact, duties and responsibilities of the auditor on the communication with management can be clarified as follows:

Paragraph (3) of the ISA 260 refers that, for the purposes of this standard, ‘governance’ is considered the term used to indicate the role of persons in charge of supervision, control and directing of an establishment. Those in charge of governance are usually responsible for ensuring that the facility realises its objectives, and financial reports are made and presented to the interested parties. Those in charge of governance include management only it performs these tasks.

For the purpose of ISA 260, Paragraph (4) indicates that the audit matters that are important for governance are those things that result from audits of financial statements, which in the auditor’s opinion are important and appropriate for those charged with governance of overseeing the financial reporting and disclosure. The key audits issues essential only for governance include those matters that fall within the interest of the auditor as a result of the
performance of the audit process. The auditor is not required in an audit by international auditing standards to design the procedures for a specific purpose which is the identification of the audit matters that are important for governance.

There is a necessity that the auditor should take into account the following:

1. Control structures vary from one country to another and reflect the cultural and legal backgrounds. For example, in some countries the supervision function and the management function are legally divided into two different bodies, as a supervisory board (complete or major non-executive) and the administrative board (executive). In some other countries both the tasks are the legal responsibility of a single, unified council. Although there may be an audit committee to assist the board in oversight responsibilities with respect to financial reporting, this difference makes it difficult to put forth a universal identification for persons charged with governance and those related with the auditor on matters of audit critical for oversight, taking into account the regulatory structure of the facility, the conditions of the process, and any special relevant legislation. The auditor should also take into consideration the legal responsibilities of such persons; for example, in establishments where there are supervisory boards or audit committees, the right people may be those bodies. Yet, in facilities where the unified council has formed an audit committee, the auditor may decide to communicate with the audit committee or with the council as a whole, depending on how important audit things are for governance.

2. When the regulatory structure of the facility is not well defined, or those in charge of control are not clearly specified through the circumstances of the process or through legislation, the auditor must reach an agreement with the facility that will be contacted on matters of audit that are important for control; examples of this include some of the facilities run by owners, some non-profit organizations, and some government agencies.

3. To avoid misunderstandings it is possible that the letter of appointment can illustrate that the auditor will communicate only with respect to matters that are important to control to draw attention as a result of the performance of audit, and that the auditor is not required to design procedures for the purpose specified, which is to identify issues important for governance. The letter of appointment may as well relate to the following:
- Statement of the form through which any special connections that are important for the audit matters of governance are made.
- Identification of the right people who will be contacted.
- Determination of specific audit issues important for the governance which has agreed to contact them.

4. Improvement of the effectiveness of communication through the development of a constructive working relationship between the auditor and those charged with governance on audit matters important to the control that will be contacting them, developing this relationship and at the same time assuming a position of professional independence and objectivity.

It is possible that the auditor makes communication with those charged with governance orally or in writing, and the decision of the auditor to contact either orally or in writing is influenced by factors such as the following:

1. The size, operational structure, legal structure, and communications operations of the facility that is audited.
2. The nature, sensitivity and importance of audit matters considered essential for the control that will be contacting them.
3. The arrangements made with respect to periodic meetings or reporting on matters important to the audit control.
4. The extent of communication and ongoing dialogue carried out by the auditor with those charged with governance.

But when the connection regarding audit matters important to control is made orally, the auditor must document in working papers the matters that have been communicated and any replies to these things. Such documentation may take the certification form transcript of discussions between the auditor and those charged with governance. In certain circumstances and depending on the the nature and sensitivity and the importance of the matter, the auditor may be advised to confirm in writing to those in charge of governance any oral private communication regarding auditing matters that are important for control.

Usually, the auditor initially discusses topics important for the control with the management except for those matters pertaining to issues related to the efficiency or integrity of management. These preliminary discussions with management are considered important in order to clarify the facts and issues and to give management an opportunity to provide more
information and, if approved by the management, contact on important issues those charged with governance control. The auditor does not need re-communication, provided that the auditor is satisfied that these communications have been effectively and appropriately made.

Based on the above, Paragraphs 13-14 of the standard regarding the timing of call have indicated the following:

1. Auditor must contact on audit matters important to the control on time, and this would allow those charged with governance to take appropriate action.
2. In order to make calls in a timely manner, the auditor must discuss the basis and timing of reporting with those charged with governance. In certain circumstances and given the nature of the issue, it is possible for the auditor to inform it by the time that was agreed upon.

4-3-2-1. The Duties and Responsibilities of the Auditor on Communication:

Paragraphs (2-3) of the International Standard No. 260 indicate that the auditor should maintain communication on important audit matters with Those Charged with Governance, and must identify the right people in charge of governance whom s/he should contact on audit matters important to control. Therefore, the auditor should consider that audit matters which are important to the control that arise from the audit of financial statements, and communicate with those charged with governance, and usually include such things as follows:

1. The general style and the overall scope of the audit, including any expected selections for this or any additional requirements.
2. The choice or changes in accounting policies and practices that have, or could have, a significant material effect on the financial statements of the enterprise.
3. The potential impact on the financial statements of any risks considered important, such as non-adjudicated litigation, which requires to be disclosed in the financial statements.
4. Audit adjustments, whether or not recorded by the establishment, and which have or could have a significant impact on the financial statements of the establishment.
5. Material uncertainties related to events and circumstances that may give rise to significant doubt about the ability of the establishment to continue business as successful.
6. Disagreements with management on matters that may collectively or individually be important to the financial statements of the establishment or the auditor’s report; these
communications include consideration of whether the issue has resolved or not, and also the importance of the issue.

7. Expected changes in the auditor’s report.

8. Other matters that require the attention of those charged with oversight, such as material weaknesses in internal control, and private matters regarding the management’s integrity, and fraud involving management.

9. Any other matters agreed in the terms of the audit process.

As part of the communication the auditor must report information to those charged with governance, including the following:

A. Communications of the auditor should include only things considered by the auditor to be important to the control as a result of the performance of the audit process.

B. The audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance and, accordingly, the audit does not identify all of these things usually.

Also, it is pointed out in Paragraphs 18-21 that the auditor, while making communication with those charged with governance, should consider the following:

1. If the auditor thinks that amendments should be made to the report on the financial statements as set out in International Standard Number (700) (the Auditor’s Report on the Financial Statements), the communications between the auditor and those charged with governance cannot be considered as an alternative.

2. The auditor should consider the possibility that audit issues which are important for the control and which have been communicated already may have an impact on the financial data for the current year. The auditor should also consider whether the issue will continue to be important for the control and whether the issue should be informed once again to those charged with governance.

3. The requirements of national bodies for professional accounting or legislation or regulation may impose obligations of confidentiality limiting the auditor’s communication on matters of audit important for the control. The auditor has to refer to these requirements, laws and regulations before communicating with those charged governance. In some cases, there may be complex conflicts with the auditor’s ethical
and legal obligations of confidentiality and reporting, and in these cases the auditor may wish to seek legal counsel. may impose

4. The requirements of national bodies for professional accounting or legislation or regulation may impose on the auditor obligations on communications on governance and related matters. These additional requirements for communications are not covered by this international scrutiny; however, these requirements may affect the content, form and timing of communications with those charged with governance.

4-3-3. The Duties and Responsibilities of Management and Auditor Regarding Going Concern:

International Auditing and Assurance Standards Board (IAASB) issued International Standard No 570 (Going Concern). The purpose of this standard is to provide guidelines on the auditor’s responsibility in the audit of financial statements with respect to the imposition of the going concern of the facility used in the preparation of financial statements, including taking into account management’s assessment of the capacity of the facility to continue. So, this standard requires the auditor – when planning and performing audit procedures and evaluating the results – to take into account the extent of appropriateness of the management’s utilisation of the imposition of the continuity of the establishment in the preparation of financial statements. Based on the above, it is possible to explain the duties and responsibilities of management and the auditor regarding sustainability, as follows:

4-3-3-1. The Duties and Responsibilities of Management regarding Going Concern:

ISA 570 indicates that the imposition of the continuity of the facility is a key principle in the preparation of financial statements. Under the imposition of the continuity of the establishment, the establishment is usually seen to be continuing its business in the near future without any objective or need to liquidate or cease trading or attempt to obtain protection from creditors under the laws and regulations; accordingly, assets and liabilities are registered on the basis that the facility will be able to realize its assets and fulfil its obligations during the course of business as usual.

The standard above also noted that some financial reports submission frameworks contain an explicit requirement of the management to conduct a specific assessment of the establishment’s capacity to continue. Besides, the detailed requirements related to the
responsibility of the management to evaluate the capacity of business to continue and the disclosure of financial data relating to this can be included in accounting standards or legislations or regulations, and specific standards for things that should be taken into account, and disclosures to be made with regard to the continuity of the establishment. For example, the first international accounting standard requires the following:

1. While preparing financial statements the management must assess the ability of the establishment to continue, and must prepare financial statements on the basis of the continuity of the establishment unless the management intends to liquidate the enterprise or cease trading or has no real alternative but to do so. When, during the assessment, the establishment is aware of the existence of material doubts relating to events or circumstances that may give rise to substantial suspicion regarding the ability of the establishment to continue, there must disclosure of these doubts. When financial statements are not prepared on the basis of continuity of the establishment, this fact must be disclosed along with the foundation on which the preparation of financial statements is made, and the reasons for not considering the establishment as sustainable.

2. When assessing whether the imposition of the continuity of the establishment is appropriate, the management must take into account all the information available for the foreseeable future, which should be at least, but not limited to, twelve months from the balance sheet date. The degree of consideration should be based on the facts in each case. When the establishment has a history of profitable operations and has the potential to access financial resources, it is possible to infer that accounting on the basis of continuity of the establishment is appropriate without detailed analysis. In some other cases the management may require to take into account a wide range of factors surrounding the current profitability, and also the prospective profitability, and the timetables for payment of debts, and potential sources of alternative funding before they convince themselves that the basis for the continuity of the establishment is appropriate.

International Auditing Standard no. 570 indicates that in some other financial reporting frameworks, there may be no explicit requirement for management to conduct a specific assessment of the capacity of the enterprise to continue. Yet, despite that the imposition of the continuity of the enterprise is a key principle in the preparation of financial statements, it is the management’s responsibility to assess the ability of the enterprise to continue, even if the financial reporting framework does not include the explicit responsibility to do so. Therefore,
when the enterprise has a history of profitable operations and access to financial resources, the management can make the assessment without detailed analysis, provided that the management’s assessment of the imposition of continuity of the enterprise includes estimation, at a particular point of time, about the outcomes of future events or circumstances, which are uncertain in nature. The following factors relate to this case:

1. Generally, the degree of associated uncertainty increases due to a specific event or condition to a great extent whenever the time of taking decision or making estimation of the outcome of the event or circumstance is far in future. For this reason, most financial reports submission frameworks require management’s explicit assessment specifying a time period during which the management has to take into account all the available information.

2. The size and complexity of the enterprise, its nature and working conditions, and the degree of its vulnerability to external factors, all affect the provision of estimation of the outcome of events or circumstances.

3. The following are examples of events or circumstances that may individually or collectively raise substantial doubt about the imposition of the continuity of the enterprise. This list is not exhaustive, and it is not always necessary for the presence of a single item or more to indicate the existence of a material doubt.

- **Financial events or circumstances:**
  - Major financial percentages are not positive.
  - Huge operational losses or decline in the value of assets available for generating cash flow.
  - Inability to pay creditors on due dates.
  - Inability to comply with the terms of loan agreements.
  - Change from credit to cash-on-delivery transactions with suppliers.
  - Inability to obtain financing for essential new product development or other essential investments.

- **Operational events or circumstances:**
  - Loss of key management without replacement.
  - Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
  - Labour difficulties.
4-3-3-2. The Duties and Responsibilities of the Auditor regarding Going Concern:

ISA 570 indicates that it is the auditor’s responsibility to consider the appropriateness of the management’s use of the imposition of the enterprise’s continuity in the preparation of financial statements, and consider whether there are material doubts needed to be disclosed regarding the ability of the business to continue. The auditor has to consider the management’s use of the imposition of the enterprise’s continuity even if the financial reporting framework does not include an explicit requirement that the management has to undertake a specific assessment of the capacity of the enterprise to continue.

The standard also confirms that the auditor cannot predict future events or conditions that may cause the enterprise to stop from continuing; accordingly, the absence of reference to uncertainty of continuity in the auditor’s report cannot be viewed as a guarantee of the capacity of business to continue, but the auditor should do the following duties:

1. When planning the audit, the auditor should take into account whether there are events or circumstances that may give rise to substantial doubt about the ability of the enterprise to continue.

2. The auditor should remain alert during the process of checking for evidence of the events or circumstances that may give rise to substantial doubt about the ability of the business to continue, and if such events or circumstances are determined, the auditor should in addition to performing the procedures set forth in paragraph 26 of ISA 570 consider whether they affect the auditor’s estimates of the components of audit risk.

3. The auditor should take into account the events and circumstances relating to the imposition of the continuity of the enterprise during the planning process, because this consideration allows for discussions with the management at more appropriate times,
reviewing management plans, and resolving any identified issues especially regarding the enterprise’s continuity.

4. In some cases the management may have conducted an initial assessment in the early stages of the audit process. If so, the auditor has to review that assessment to see whether the management has identified events or circumstances such as those discussed in paragraph 8 of ISA 570 and the management’s plans to address them.

5. If the management has not yet conducted a preliminary assessment, the auditor should discuss with the management the basis of the intended use for the imposition of continuity, and inquire of management whether events and circumstances such as those discussed in paragraph 8 exist. The auditor can request the management to begin evaluation procedure, particularly when the auditor may have identified the events and circumstances relating to the imposition of continuity.

6. The auditor should take into account the impact of specific events or circumstances while making the initial assessment of the components of audit risks and, based on that, their presence may affect the nature, timing and extent of the procedures of the auditor.

In addition to the above, the standard has included in Paragraphs 17-25 the duties of the auditor regarding the evaluation of management’s estimates of the capacity of the enterprise to continue and inquiring about the management’s knowledge of events or circumstances outside the scope of the evaluation period used by the management which might raise substantial doubt about the ability of the business to continue; these include the following:

1. The auditor should take into account the same period used by the management to conduct the evaluation under the financial reporting framework. If the management’s assessment of the capacity of the enterprise to continue covers less than twelve months from the date of the balance sheet, the auditor must request the management to extend the evaluation period to twelve months from the date of the balance sheet.

2. The management’s assessment of the capacity of the enterprise to continue is a key part of as the auditor’s consideration of the purpose of continuity. As stated in Paragraph 7 of the standard, most financial reports submission frameworks requiring explicit assessment by the management set the period of time in which the management has to take into account all available information.
3. While evaluating the management’s assessment, the auditor must consider the method used by management to conduct assessment and the assumptions upon which the assessment has been founded and the management’s plans for future action. The auditor has to consider whether the assessment has taken into account all relevant information known to the auditor as a result of the audit procedures.

4. As stated in Paragraph 6 of the standard, when there is a history of profitable operations, and a possibility of immediate access to financial resources, the management can conduct assessment without detailed analysis. In such case, the auditor usually reaches his/her own conclusions on the appropriateness of this assessment without the need for detailed procedures, provided that when the circumstances or events that raise substantial doubt about the ability of the business to continue are identified, the auditor must carry on additional audit procedures, as set out in Paragraph 26 of the standard.

5. The auditor should be alert to the possible existence of known events specified in a timeline or otherwise, or conditions that will occur outside the evaluation period used by the management which may raise questions about the appropriateness of the management’s use of the imposition of continuity in the preparation of financial statements. The auditor may become aware of these events or circumstances during the planning and conduct of the audit, including procedures for subsequent audit.

6. Where there is an increase in the degree of doubt associated with the outcome of an event or circumstance whenever this event or circumstance gets further in the future, the evaluation of such events or circumstances must heed the indications of the topics related to continuity before the auditor considers taking further action. The auditor may need to request the management to determine the potential significance of the event or circumstance for the evaluation of continuity.

7. The auditor is not responsible for the development of procedures other than inquiring the management to make tests for clues about the events or circumstances that raise substantial doubt about the ability of the business to continue beyond the period estimated by the management which, as discussed in Paragraph 18 of ISA 570, is at least 12 months from the date of the balance sheet.

8. The events and circumstances that may raise substantial doubt about the ability of the enterprise to continue could be identified during the planning process or during the
conduct of audit procedures. The process of considering events or circumstances continues during the course of the audit. When the auditor thinks that these events or circumstances may give rise to substantial doubt about the capacity of business to continue, certain procedures become more important. The auditor has to inquire the management regarding its plans for future actions, including plans to liquidate assets, borrow money, restructure debt, reduce or delay expenditures, or increase capital. Also, the auditor has to take into account whether there have been any additional facts or information available since the date in which the management conducted the evaluation. The auditor has to obtain sufficient and appropriate audit evidence that the management’s plans are viable and the result of these plans will improve the situation.

9. The appropriate measures in relation to this matter may include the follows (ISA, 2010; 255-256):

- Analyzing and discussing cash flow, profit and other relevant forecasts with management.
- Analyzing and discussing the entity’s latest available interim financial statements.
- Reading the terms of debentures and loan agreements and determining whether any have been breached.
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- Inquiring of the entity’s legal counsel regarding the existence of litigation and claims and the reasonableness of management’s assessments of their outcome and the estimate of their financial implications.
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- Evaluating the entity’s plans to deal with unfilled customer orders.
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity’s ability to continue as a going concern.
- Confirming the existence, terms and adequacy of borrowing facilities.
- Obtaining and reviewing reports of regulatory actions.
• Determining the adequacy of support for any planned disposals of assets.

10. The phrase “material uncertainty” is used in IAS 1 in discussing the uncertainties related to events or conditions which may cast significant doubt on the entity’s ability to continue as a going concern that should be disclosed in the financial statements. In some other financial reporting frameworks the phrase “significant uncertainty” is used in similar circumstances.

11. The determination of the adequacy of the financial statement disclosure may involve determining whether the information explicitly draws the reader’s attention to the possibility that the entity may be unable to continue realizing its assets and discharging its liabilities in the normal course of business.

12. If the entity’s management is required, or elects, to prepare financial statements when the use of the going concern assumption is not appropriate in the circumstances, the financial statements are prepared on an alternative basis (for example, liquidation basis). The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the alternative basis is an acceptable financial reporting framework in the circumstances. The auditor may be able to express an unmodified opinion on those financial statements, provided there is adequate disclosure therein but may consider it appropriate or necessary to include an Emphasis of Matter paragraph in the auditor’s report to draw the user’s attention to that alternative basis and the reasons for its use.

13. In certain circumstances, the auditor may believe it necessary to request management to make or extend its assessment. If management is unwilling to do so, a qualified opinion or a disclaimer of opinion in the auditor’s report maybe appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding the use of the going concern assumption in the preparation of the financial statements, such as audit evidence regarding the existence of plans management has put in place or the existence of other mitigating factors (ISA, 2010; 257-259).

4-3-4. The Duties and Responsibilities of Auditor on Communicating Deficiencies in Internal Control to Those Charged with Governance:

1. The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.
2. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

3. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.

4. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:
   (a) In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and
   (b) Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor’s professional judgment, are of sufficient importance to merit management’s attention.

5. The auditor shall include in the written communication of significant deficiencies in internal control:
   (a) A description of the deficiencies and an explanation of their potential effects; and
   (b) Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that:
      - The purpose of the audit was for the auditor to express an opinion on the financial statements;
      - The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
      - The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance. (IFAC, 2010, pp:238-240).
4-4. Professional Factors related to International Internal Auditing Standards:

Internal auditing is one of the pillars and foundations of corporate governance of banks and, therefore, developing and raising the efficiency level of the professional performance of internal audit have become a key support of the effective application of governance framework. As a result, the Institute of Internal Auditors has re-evaluated the principles governing the internal audit function, in addition to the provision of a base of knowledge and skills necessary for and inherent to the profession within the framework of a comprehensive review of the existing professional standards and ethical codes in order to raise the efficiency and develop the professional performance of the internal auditor and enhance the status of the profession of internal auditor in the competitive market (Mohammad, 2005:352).

The Institute of Internal Auditors in the United States (IIA) issued other amendments and additions to the International Standards for the Professional Practice of Internal Auditing in 12/2003, which became effective as of 1/1/2004, and even modified them further in 15/04/2004. Given the importance of the role of internal audit in business organizations, considered as the eye and ear of the Audit Committee and the most important mechanism of corporate governance, Internal Auditing has been identified as (IIA, 2004):

an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

In the opinion of Zabihollah (2007:308), internal auditors can play an important role in corporate governance through their active participation in: (1) promoting corporate governance best practices and appropriate ethics and culture within their organizations; (2) communicating important corporate governance issues and practices to their organization’s officers and directors; (3) enforcing compliance with applicable laws, rules, regulations, and standards throughout their organization; (4) preventing, detecting, and correcting governance risks, internal control deficiencies, and financial reporting Irregularities and fraud; and (5) serving as a vital information source to their organization’s board of directors, particularly the audit committee.
4-4-1. The Role of the Development of Internal Auditing in the Activation of Governance:

A number of scientific academies and professional organizations have made attempts at the development of the concept of internal auditing with an aim to provide a new conceptualization of the profession and reflect its impact on the activation and support of corporate governance. The most notable manifestations of this evolution include (Ashmawi, 2005:11):

1. Internal auditing is considered an activity independent of the executive management of the bank as a result of its subordination to the Governing Board within the circle of the Audit Committee emerging out of it. Internal auditing reports are submitted to this Council and to the shareholders if necessary.

2. It is an objective activity that carries out the work of internal audit by experienced and highly skilled professionals, whether from inside or outside the bank.

3. The scope of internal audit has expanded to include advisory services in addition to confirmation, inspection, and evaluation services: this is an explicit confirmation directed to customer service, going beyond the traditional functions, which supports the role of internal audit in the field of risk assessment and supporting the system of governance.

4. The strategy of internal audit has been developed so that it can add value to the organization and improve its operations. Therefore, the new concept emphasizes the essential contribution of internal audit to achieving the overall objectives of the organization.

5. There is an emphasis on considering the elements of the internal control system as a necessary input to help business organizations to provide a new and acceptable system of governance to banks. Therefore, it has become necessary for the internal auditor to carry out new functions and responsibilities in several areas, including risk management, control and governance system.

6. The internal auditor is committed to perform confirmation services that focus on the objective evaluation of the evidence in order to form an independent technical opinion on professional business.

7. A set of basic principles have been established to draw the image that reflects the methodology of exercising the profession of internal audit, and develop a general
framework to improve the performance of its activities for the purpose of improving the quality of the profession and enhancing its operations.

In late 2003, Security Exchange Committee (SEC) approved a list of regulations of corporate governance, including a request for internal audit of economic units listed in New York Security Exchange (NYSE) so as to improve the level of application of corporate governance in these companies (Tone at the top, IIA: 2004:1-2).

In connection with the development of internal auditing, Dana & Larry (2003) have pointed out that the development of the code of ethics of the profession of internal auditing has become a key factor in supporting corporate governance since the development of the internal audit profession has come to serve parties exercising an important role in governance and also add value to them by ensuring the drawing of strategic goals for economic units in a manner to realise the interests of all parties in fair methods. From this perspective, we can say that internal audit serves two groups:

- Those responsible for corporate governance by examining their methods of work and ensuring their integrity.
- Those who are subject to corporate governance by ensuring that the work of those responsible for corporate governance is in their favour (Dana & Larry 2003:58-59).

Based on the fact that the internal audit is an attribution factors of corporate governance and a reflection of the evolution of internal audit standards on the role of internal auditor, the traditional role of the internal auditor has changed and bypassed the process of determining the risks of the internal control system and has reached the point of playing a major consulting role to develop and modify the major indicators of operating performance. The internal auditor has become required to have a number of technical skills to assist in understanding the plans and foundations of programs and to qualify him/her to work and make the necessary recommendations to reduce costs while maintaining the same level of quality in performance (Alwardat 2005:141).

4-4-2. The Role of the Code of Ethics of Internal Audit in the Activation of Governance:

Accounting literature has dealt with the activation of the principles of governance, indicating that the evolution of ethics of the profession contributes to the support of the basics of governance and generates a suitable environment to support the role of governance, as shown by the following (Nasman, 2009: 40-41):
1. The internal audit function in banks usually uses other parties that play an important role in the process of governance, such as the Board of Directors, the Audit Committee and the External Auditor. In addition, the internal audit function serves and adds value to those who are subject to banks governance, such as management, individual organizational units, and operations management. As a result, the internal audit function usually serves those who are responsible for or subjected to corporate governance of banks.

2. Many of the activities performed by the internal audit function become part of the structure of the bank’s control.

3. The internal audit function can be done from within the bank or by relying on an external source, i.e. audit firms. The contemporary trends in this regard reflect that most countries tend to rely on external sources in the performance of the internal audit function to overcome what may likely be lacking in terms of experience, competencies and skills required.

**According to IIA, the Code of Professional Conduct has stated the following** (IIA 2009:8):

**1. Integrity of Internal auditors:**

1.1. Shall perform their work with honesty, diligence, and responsibility.

1.2. Shall observe the law and make disclosures expected by the law and the profession.

1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.

1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

**2. Objectivity of Internal auditors:**

2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.

2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.

2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

**3. Confidentiality of Internal auditors:**
3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.

3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

4. Competency of Internal auditors:

4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.

4.2. Shall perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing.

4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

Clearly, the above reflects the importance of setting forth the new principles of the code of ethics of the internal audit profession which includes objectivity, confidentiality, integrity, and professionalism in order to avoid potential conflicts and to maintain the independence of the internal auditor, and thereby support corporate governance of banks.

4-4-3. The Evolution of Internal Auditing Standards in the light of Corporate Governance:

Internal audit activities are carried out in varying cultural, legal and economic environments, and are executed in companies that vary in size, objectives and organizational structures, and by different people. All those variations and differences may affect the performance of internal audit activities in different environments. So, it is necessary to subject the internal auditing standards to a continuous process of evaluation and development to facilitate and control the work of internal auditors in light of these criteria.

A part of the response to the global financial crises and developments that took place in the global economy, and the view that corporate governance can be a remedy for that, is represented by the development of the role of internal audit and the functions it performs. The realisation of this matter is more easily achieved through the development of standards of internal audit in the light of the requirements of corporate governance. In order to do so, the Institute of Internal Auditors “IIA” has issued modern standards to keep pace with economic developments: the new auditing standards have been issued in the two groups (IIA, 2009):
1- Attribute Standards:

- **1000 – Purpose, Authority, and Responsibility**
  The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

- **1100 – Independence and Objectivity**
  The internal audit activity must be independent, and internal auditors must be objective in performing their work.

- **1200 – Proficiency and Due Professional Care**
  Engagements must be performed with proficiency and due professional care.

- **1300 – Quality Assurance and Improvement Program**
  The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.

2- Performance Standards:

- **2000- Managing the Internal Audit Activity**
  The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.

- **2100 – Nature of Work**
  The internal audit activity must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach.

- **2200 – Engagement Planning**
  Internal auditors must develop and document a plan for each engagement, including the engagement’s objectives, scope, timing, and resource allocations.

- **2300 – Performing the Engagement**
  Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement’s objectives.

- **2400 – Communicating Results**
  Internal auditors must communicate the engagement results.

- **2500 – Monitoring Progress**
The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

- **2600 – Resolution of Senior Management’s Acceptance of Risks**

When the chief audit executive believes that senior management has accepted a level of residual risk that may be unacceptable to the organization, the chief audit executive must discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive must report the matter to the board for resolution.

The Standard no. 2130, derived from Standard no. 2100 of the second group is related to corporate governance, and suggests that the internal audit activity should contribute to the processes of corporate governance by contributing to evaluating and improving the process of governance through the following:

A. Checking the status of setting up values and goals and their realisation so that managements become prepared and able to disclose that their activities, actions and decisions are in conformity with the objectives set and agreed upon.

B. Controlling the process of achieving goals through:

- Evaluating the quality of executed performance on the level of responsibilities assigned to staff.
- Providing appropriate recommendations to enhance the company’s operations and development.
- Raising the productive efficiency through training by proposing the necessary measures.
- Verification of accountability, as the actions and decisions taken are subject to inspection by internal audit.
- Verification of maintaining the values of the company by identifying areas or processes and programs that must be reviewed and evaluated during the audit.

In this way, it becomes clear that the standards of internal auditing play a role in the activation of governance, which has also been referred to in the International Standard by the development of appropriate recommendations to improve governance processes to accomplish the following objectives (2008, IIA):

- Strengthening the appropriate ethics and values within the organization.
- Confirming and managing effective organizational performance and accountability.
- Activating the delivery of important information about risks and control in the appropriate administrative levels within the organization.
- Assisting in the improvement of the interaction between the Board of Directors and senior management and internal and external auditors.

4-4-4. Audit Committees:

When talking about internal audit and its development to function as a means of support and attribution for corporate governance, it is necessary to refer to audit committees, which play an important role in corporate governance. An audit committee can be envisaged as “a committee emerging from the Board of Directors, consisting of not less three of the non-executive members of the Board of Directors and preferably having financial and accounting experience, or at least some of them”. Audit committee is considered as one of the pillars of corporate governance. There are various opinions linking the success of corporate governance to the success of audit committees in the performance of their work in the companies properly; and, vice versa, any failure, whether in the role, membership, efficiency or obligation of the audit committee, creates a gap in the application of corporate governance and makes it difficult to obtain sound results (Alraheli, 2008: 195-196).

The establishment of audit committees in companies has resulted in many benefits for the audit department within a company, especially for internal audit. The audit committee chooses a head of internal audit and provides for the needs of this section and the continuous meeting with those in charge of internal audit to resolve problems that may arise between internal auditors and the board of management or administration at all levels. In this regard, scientific research has stressed the presence of a complementary relationship between audit committees and internal audit, and emphasized the importance of audit committees in enhancing the effectiveness of internal audit by enhancing the effectiveness of internal auditors and strengthening their independence. On the other hand, the existence of audit committees enables internal auditors to increase their interaction with the external auditor, considering that one of the responsibilities of the audit committee is to coordinate and increase communication between the external auditor and internal auditors in such a way as to help both parties to fulfil their obligations and responsibilities and increase the reliability of the financial information and reports produced by the accounting system in the company (Suleiman, 2006: 147-148).
Therefore, audit committees are not only a good tool of corporate governance in banks, but also one of the main pillars for the success of governance in banks. The role of audit committees in this regard is evident by the following (Lawrence J. 2007: 808):

- To achieve effective coordination with external auditors by identifying the area of audit and reviewing financial statements before and after deployment, in addition to the verification of management’s response to the observations and recommendations of the auditors and the Capital Market Authority.
- To assess financial aspects by reviewing the performance of accounts management and financial management and evaluating the financial policies of the bank.
- To examine and evaluate the work of the internal audit department to make sure of the adequacy of internal audit programs as well as the adequacy of the internal audit team to fulfil the tasks entrusted to do.
- To appoint or dismiss auditors, as well as participate in the setting of fees.
- To ensure the effectiveness of internal control procedures and compliance rules and standards.

The function of audit committees boils down to effective supervision of the financial reporting process, showing these reports in a high quality and adequacy. Audit committees also protect the rights of shareholders and other stakeholders. It is clear that in order to make audit committees effective in their supervision of the financial reporting process, they cannot operate in a vacuum. Because these committees rely on information submitted to them by senior financial management and internal audit staff and external auditors in order to carry out their responsibilities, it is important that such committees create an open, free, explicit and systematic dialogue with each of the those involved with them at work. In fact, financial accounting and the process of preparing high quality financial reports, which constitutes the ultimate goal of the process, cannot be produced without effective communication between those involved in it (Adeyemi and Fagbemi 2010: 171).

In this way, internal audit has shouldered a huge responsibility towards the company itself and towards shareholders and other stakeholders in the company. In addition to the internal audit’s role of providing advisory services to the company, it contributes significantly to providing information that helps in decision-making within the company and outside, which in turn leads to effective utilisation of the company’s unique organizational resources. The most important feature of the evolution of internal audit is the emergence of evaluation and
improvement of corporate governance processes as one of its objectives: internal audit has become an integral and necessary part in the structure of corporate governance through its role in evaluation, verification, accountability and creating confidence in the management’s operations and financial reporting. Besides, it contributes through corporate governance to preserving the company’s funds and improving its investment in order to increase the company’s value by raising the market value of the shares in the securities markets. All that comes together in the protection of the rights of shareholders (especially the minor ones) and this in itself represents a bulk of the objectives of corporate governance.

4-5. Professional Factors relating to Rules of Ethical Conduct for Accountants:

The code of professional conduct represents the most important set of rules to adhere to professional ethics. Chartered accountants ethics, issued by International Federation for Accountants, indicate that the distinctive feature is the acceptance of its responsibility towards the public. The audit profession has obtained a wide reputation of integrity, objectivity and competency through years of service to customers, entrepreneurs and the public. An auditor’s general failure or failure in compliance to professional standards and legal obligations makes it difficult to maintain a good reputation of the profession.

Since the 1970s, corporations have addressed business ethics in various ways, including the introduction of compliance programs and managers, the addition of board-level ethics committees, the development of codes of conduct, the preparation and dissemination of values statements, the hiring of corporate social responsibility managers and training programs of all kinds. As the events of the past few years in the United States and Europe have demonstrated, these efforts, unfortunately, have not prevented U.S.-based and European-based corporations from engaging in unethical behaviours that lead to larger corporate scandals. As a result there is increased pressure for U.S. and European companies and governments to provide more structured governance and ethics programs so that companies are more responsible to the societies in which they operate (Nathan, 2004:5).

The most important laws that encourage adherence to professional ethics are the rules of professional conduct, indicate the rules of professional conduct for Certified Public Accountants issued by the International Federation of Accountants to be the hallmark of the profession is to accept their responsibilities to the public has received the audit profession’s reputation enjoyment of integrity, objectivity and efficiency through the early years many In the service of clients, employers and the public, and all the auditor fails to note that, or fails to
comply with professional standards and legal requirements makes it difficult to maintain the reputation of the profession to which he belongs.

4-5-1. Rules of Professional Conduct issued by the International Federation of Accountants:

The aim of these international rules is to serve as a model of moral and national guidelines which set standards for professional accountants, and set the basic principles which accountants must take into account to achieve common goals. The accounting profession throughout the world is available in environments with different cultures and different regulatory requirements. The basic objective of the rules of ethical conduct must be respected. It is also known that in the event of a conflict between national requirements with the provisions of these rules, the former will be prevalent. But for a country that wants to adopt these rules as national rules, the International Federation has developed a formula that can be used as an indicator of the power of that state and the possibility of application.

Perhaps the most important points of the standards issued by the International Ethics Standards Board for Accountants (IESBA) which professional accountants should take into account include the basic principles of integrity, objectivity, professional competence, due diligence, confidentiality, professional conduct, and technical standards. The guide of professional ethics has been divided into three Parts: Part (a) applies to all professional accountants (General); Part (b) pertains to all professional accountants in the public sector; while Part (c) relates to employed professional accountants. The following is a summary of the contents of the guide of professional ethics:

4-5-1-1. Part A-General Application of the IESBA Code:

This Code contains three parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework that professional accountants shall apply to:

- Identify threats to compliance with the fundamental principles;
- Evaluate the significance of the threats identified; and
- Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to
conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

1- **Section (110) Integrity:** The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information furnished recklessly; or

(c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

2- **Section (120) Objectivity:** The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.

3- **Section (130) Professional Competence and Due Care:** The principle of professional competence and due care imposes the following obligations on all professional accountants:

(a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services.

4- **Section (140) Confidentiality:** The principle of confidentiality imposes an obligation on all professional accountants to refrain from:

(a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and

(b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.
Section (150) Professional Behaviour: The principle of professional behaviour imposes an obligation on all professional accountants to comply with relevant laws and regulations and avoid any action that the professional accountant knows or should know may discredit the profession. This includes actions that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.

4-5-1-2. Part B- Professional Accountants in Public Practice:

This Part of the Code describes how the conceptual framework contained in Part A applies in certain situations to professional accountants in public practice. This Part does not describe all of the circumstances and relationships that could be encountered by a professional accountant in public practice that create or may create threats to compliance with the fundamental principles. Therefore, the professional accountant in public practice is encouraged to be alert for such circumstances and relationships.

1. Section (210) Professional Appointment:

Client Acceptance: Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behaviour may be created from, for example, questionable issues associated with the client (its owners, management or activities).

Engagement Acceptance: The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

Changes in a Professional Appointment: A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, shall determine whether there are any reasons, professional or otherwise, for
not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

2. Section (220) Conflicts of Interest: A professional accountant in public practice shall take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may create threats to compliance with the fundamental principles. For example, a threat to objectivity may be created when a professional accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. A threat to objectivity or confidentiality may also be created when a professional accountant in public practice performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question.

3. Section (230) Second Opinions: Situations where a professional accountant in public practice is asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client may create threats to compliance with the fundamental principles. For example, there may be a threat to professional competence and due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing accountant or is based on inadequate evidence. The existence and significance of any threat will depend on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.

4. Section (240) Fees and Other Types of Remuneration: When entering into negotiations regarding professional services, a professional accountant in public practice may quote whatever fee is deemed appropriate. The fact that one professional accountant in public practice may quote a fee lower than another is not in itself unethical. Nevertheless, there may be threats to compliance with the fundamental principles arising from the level of fees quoted. For example, a self-interest threat to professional competence and due care is created if the fee quoted is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.
5. Section (250) Marketing Professional Services:

6. Section (260) Gifts and Hospitality

7. Section (270) Custody of Client Assets: A professional accountant in public practice shall not assume custody of client monies or other assets unless permitted to do so by law and, if so, in compliance with any additional legal duties imposed on a professional accountant in public practice holding such assets.

8. Section (280) Objectivity – All Services: A professional accountant in public practice shall determine when providing any professional service whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or its directors, officers or employees. For example, a familiarity threat to objectivity may be created from a family or close personal or business relationship.

9. Section (290) Independence – Audit and Review Engagements: This section addresses the independence requirements for audit engagements and review engagements, which are assurance engagements in which a professional accountant in public practice expresses a conclusion on financial statements. Such engagements comprise audit and review engagements to report on a complete set of financial statements and a single financial statement. Independence requirements for assurance engagements that are not audit or review engagements are addressed in Section 291.

Independence comprises:

- **Independence of Mind:** The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism.

- **Independence in Appearance:** The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firms, or a member of the audit team’s, integrity, objectivity or professional scepticism has been compromised.

Even when not required by the Code, applicable auditing standards, law or regulation, regular communication is encouraged between the firm and those charged with governance of the audit client regarding relationships and other matters that might, in the firm’s opinion, reasonably bear on independence. Such communication enables those charged with governance to:
Consider the firm’s judgments in identifying and evaluating threats to independence,
Consider the appropriateness of safeguards applied to eliminate them or reduce them
to an acceptable level, and
Take appropriate action. Such an approach can be particularly helpful with respect to
intimidation and familiarity threats

10. Section (291) Independence—Other Assurance Engagements: This section
addresses independence requirements for assurance engagements that are not audit or review
engagements. Independence requirements for audit and review engagements are addressed in
Section 290. If the assurance client is also an audit or review client, the requirements in Section
290 also apply to the firm, network firms and members of the audit or review team. In certain
circumstances involving assurance engagements where the assurance report includes a
restriction on use and distribution and provided certain conditions are met.

4-5-1-3. Part C—Professional Accountants in Business:
This Part of the Code describes how the conceptual framework contained in Part A
applies in certain situations to professional accountants in business. This Part does not describe
all of the circumstances and relationships that could be encountered by a professional
accountant in business that create or may create threats to compliance with the fundamental
principles. Therefore, the professional accountant in business is encouraged to be alert for such
circumstances and relationships.

1. Section (310) Potential Conflicts:

2. Section (320) Preparation and Reporting of Information: Professional accountants
in business are often involved in the preparation and reporting of information that may either be
made public or used by others inside or outside the employing organization. Such information
may include financial or management information, for example, forecasts and budgets,
financial statements, management’s discussion and analysis, and the management letter of
representation provided to the auditors during the audit of the entity’s financial statements. A
professional accountant in business shall prepare or present such information fairly, honestly
and in accordance with relevant professional standards so that the information will be
understood in its context.

A professional accountant in business shall take reasonable steps to maintain information
for which the professional accountant in business is responsible in a manner that:
• Describes clearly the true nature of business transactions, assets, or liabilities;
• Classifies and records information in a timely and proper manner; and
• Represents the facts accurately and completely in all material respects.

3. Section (330) Acting with Sufficient Expertise: Circumstances that create a threat to a professional accountant in business performing duties with the appropriate degree of professional competence and due cares include having:
• Insufficient time for properly performing or completing the relevant duties.
• Incomplete, restricted or otherwise inadequate information for performing the duties properly.
• Insufficient experience, training and/or education.
• Inadequate resources for the proper performance of the duties.

4. Section (340) Financial Interests: Professional accountants in business may have financial interests, or may know of financial interests of immediate or close family members, that, in certain circumstances, may create threats to compliance with the fundamental principles. For example, self-interest threats to objectivity or confidentiality may be created through the existence of the motive and opportunity to manipulate price sensitive information in order to gain financially. Examples of circumstances that may create self-interest threats include situations where the professional accountant in business or an immediate or close family member:
• Holds a direct or indirect financial interest in the employing organization and the value of that financial interest could be directly affected by decisions made by the professional accountant in business;
• Is eligible for a profit related bonus and the value of that bonus could be directly affected by decisions made by the professional accountant in business;
• Holds, directly or indirectly, share options in the employing organization, the value of which could be directly affected by decisions made by the professional accountant in business;
• Holds, directly or indirectly, share options in the employing organization which are, or will soon be, eligible for conversion; or
• May qualify for share options in the employing organization or performance related bonuses if certain targets are achieved.
5. **Section (350) Inducements:** The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in business shall not accept the inducement. As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, merely from the fact of the offer having been made, additional safeguards shall be adopted. A professional accountant in business shall evaluate any threats created by such offers and determine whether to take one or more of the following actions:

- Informing higher levels of management or those charged with governance of the employing organization immediately when such offers have been made;
- Informing third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a professional accountant in business may however, consider seeking legal advice before taking such a step; and
- Advising immediate or close family members of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements, for example, as a result of their employment situation; and
- Informing higher levels of management or those charged with governance of the employing organization where immediate or close family members are employed by competitors or potential suppliers of that organization (IESBA CODE OF ETHICS, 2010).

It is worth mentioning that Yemen does not have any specific authorities to determine standards for accounting, systematic review or any true professional local test or any specific framework for accounting standards or auditing standards. External audit is required for limited liability companies and joint stock companies and their branches as mentioned above but without any standards and this requirement is meaningless to some extent. Internal Audit in its comprehensive sense is absolutely not required by law or regulation. The only notable exception is the banks. Since many years, the Central Bank of Yemen (CBY) has laid, with the help of consultants, a comprehensive framework for reports based mainly on International Accounting Standards. The current framework has somewhat deviated from certain elements of the International Financial Reporting Standards as the disclosure requirements of International
Financial Reporting Standards that relate to particular financial instruments and risks have become more complex. The changes in the framework of the Central Bank of Yemen continued lagging behind and did not keep pace with rapid recent changes in the international standards of preparation of reports. However there is a meaningful framework for the preparation of bank reports in Yemen. Islamic banks are subject to similar rules, and consider the prevailing international standards applicable to Islamic banks.

As for reviewing, and given the lack of any body that sets standards or a system of local control and professional discipline, the Central Bank of Yemen has made a very short list of accredited auditors to review the banks. Each company on the approved list belongs to a certain level in a global accounting company because it is believed that membership ensures a certain level of supervision by the “mother” company or association, which both the Central Bank of Yemen and the Association of Yemeni Chartered Accountants lack the ability or the authority to provide.

The Central Bank of Yemen may inform or possibly fine any bank that commits reporting infringements. Outside the banking sector, there are a few specific disclosure items legally acceptable to specialized bodies such as the oil operating companies and insurance companies, but there is no comprehensive framework for the preparation of reports or standards system outside the requirements that are not clear to corporate laws and income tax mentioned above. The Association of Yemeni Chartered Accountants has held several meetings and conferences with the Central Agency for Accounting and Auditing, both promised to issue Yemeni accounting and auditing standards and but this has not happened yet.
References


