

THE PROCESS AND ASSESSMENT OF INTERNATIONAL STANDARDS FOR AUDIT

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Let me begin with a disclaimer that the opinions in this presentation are my own and do not, unless explicitly stated, necessarily represent IOB policy.

The assurance of high quality financial reporting is a generally accepted and strongly needed objective. So is the assurance of high quality audits. In fact, the two are mutually reinforcing parts of the more general goals of corporate transparency and market integrity.

The endorsement of IFRS by IOSCO a few years ago created a great deal of momentum towards the adoption and implementation of high quality standards of accounting. The main task now has shifted to the quality of implementation and to the necessary readjustments required to standards in an active and growing world market. With respect to ISAs, the International Standards on Auditing, the process is still at a much earlier stage, and IOSCO is now starting to consider their endorsement.

I would like to provide some thoughts on the basis on which such an endorsement could be offered.

First, let me refer to some very basic facts about the present setup of international standard setting for the audit function. For some years this activity has taken place under the aegis of the International Federation of Accountants (IFAC). But since 2005, on the basis of an agreement of several world regulatory organizations (including IOSCO as a more prominent member) with IFAC, an independent body, the IOB, was established to oversee this activity and ensure that it is carried out in the public interest. We have already worked for two years towards that objective.

Audit standards are in fact a regulatory tool, a tool which is set down ex ante and which furnishes a set of objectives and describes the process to be followed by auditors. As all regulatory tools which aspire to general application, international standards on auditing must be based on principles that can be generally implemented in a variety of jurisdictions and conditions. Yet they must be very clear and concise and spell out objectives and requirements in a way that facilitates two purposes: (a) the comparability of practice; and (b) the external evaluation of that practice. The latter purpose is itself a regulatory tool used around the world by newly-established independent audit regulators. But this is a tool used ex-post, that is, after the audit is conducted, so it should be clear that its focus and purpose are different from those of the ex ante tool created by standard setting.

For audit standards to be internationally validated and accepted, it is not enough that they are of high quality. The IOB acknowledged, and makes it a basis of its policy, that standard setters and the standard-setting process must also command credibility and excellent reputation. It follows that a great deal of our work – and our mandate -- have been devoted to overseeing two main areas of activity: the renewal of composition of the standard setting bodies; and the strict adherence to due process followed by these bodies before finalizing each and every international standard.

Over the last two years, the composition of standard-setting bodies has been shifting very considerably towards a stronger presence of non-practicing auditors, towards wider regional representation and towards greater representation from small and medium-sized practices. This goal of improved representation must of course be coupled with a search for high quality individuals who have the both necessary expertise and the ability

to act independently. The task of following up on the performance of members of the standard setting boards is now an important item on our agenda.

An equally important part of standard-setting is adherence to due process, and one of the first tasks the IOB set for itself was to approve a revised and enhanced due process for standard setters. We now place a great deal of emphasis on ensuring that this approved due process is followed, to ensure that standard setting is sufficiently responsive to the needs and perceptions of various stakeholders around the world, with the primary emphasis on investors, regulators, and corporate users. At the same time, following due process does not mean that standard setting can satisfy all viewpoints; international standard-setting experience has demonstrated that synthesis and compromise are frequently necessary. But synthesis and compromise must always respect the broader public interest and must always err – if they have to err - on the side of transparency and reliability.

One of the realities of international standard setting as we have come to see them in the IOB is the constant tension between “principles” and “prescriptive rules”. A variety of stakeholders have pressed for “prescriptive rules” in order to create legal certainty and administrative clarity. This is a tension that is well known to security regulators. If one has international convergence in mind, principle-based standards must be pursued. Yet, it is well known that too wide and high-level principles can compromise convergence at the level of regulatory or audit practice. Therefore, discovering the right balance between “principles” and “prescriptive rules”, as well as the right balance between the fine-tuning of ex ante standards and the quality of implementation are the great challenges ahead of us. These are not easy challenges but neither are they insurmountable. IOSCO itself has a wide and valuable experience in this area as a formulator of world regulatory principles and standards.

Let me finally state my opinion on what objectives IOSCO could look for when it assesses international audit standards. One definite class of criteria for endorsement could involve the content, format and degree of prescriptiveness used for each standard. A second would be adherence to due process and the degree to which standard setters have responded to reasonable stakeholder input. The final class would evaluate how well these standards align to perceived investor needs and to emerging regulatory requirements. This last filter needs clear definition and should be mindful of the need for proper balance between “principles” and “prescriptive rules”.

We are at a juncture where opinion as to the objectives, the process and the benefits of high quality audits appears to be at a high – and rare – level of convergence. There is very little difference in various stakeholder goals and the architecture of international standard setting includes a number of safeguards. This positive juncture augurs well for execution of a global strategy focused on achievement of high quality financial reporting and its salutary effects on market integrity.