

THE REGULATION OF AUDIT: NATIONAL RESPONSES AND THE INTERNATIONAL PUBLIC INTEREST

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Regulation and Self-Regulation

- A. The scandals, frauds and failures of the last decade have led to the setting of an urgent agenda, for politicians, regulators, and policy makers in general: to cure audit practice from all possible sources of corruption, lack of transparency, lack of consistency and low quality of care. Now, audit practice was not universally corrupt quite obviously, but the things that needed fixing were pretty serious. The main item that was quickly subjected to reform was self-regulation. In most large jurisdictions self regulation of auditors has been abolished, as the main means of control upon professional practice and behavior. What has replaced self regulation exhibits great variation. Audit regulators have sprung up in many countries. In some cases they set standards and regulate behavior by inspecting outcomes. In other cases they only regulate. In most cases they are positioned above the profession in a clear-cut supervisory role. Traditions, political realities, and the occurrences of corporate frauds and failures have varied across countries, and so have varied the political responses to the demands for regulatory intervention. One general conclusion can be reached however from responses around the world: The elimination of self-regulation of the audit profession is becoming a global reality. The profession is coming under public supervision of one form or another.
- B. Two questions pose themselves, after these developments. Is the quality of audit going to improve or not? Is the practice of audit going to be more consistent across jurisdictions or not? The importance of the first question is as serious as that of the second question. The

importance of the second question is paramount in markets that are linked within the global environment.

- C. It is my guess that the intensive scrutiny to which the audit profession has been subjected has led so far to positive results. Audit firms have reinforced their internal quality controls and have embarked on quality enhancement efforts. Auditors have become much more conscious of the need to be independent, act independently and offer their objective and unbiased judgment to the users of the financial statements. Users have become far more conscious of the need to scrutinize the credentials, the quality and the consistency of the work of auditors. Regulators of all stripes – especially security market regulators – are very intensely searching for safeguards in the integrity of audits, the quality of information that goes to markets, and the international comparability of accounting numbers.

The Need for International Cooperation

- D. The creation of a variety of audit regulators across the world poses with great urgency the issue of their coordination. This is a central problem of our present regulatory reality, since markets globalize and extend beyond national jurisdictions. National regulators have to cooperate with other regulators at two levels at least. First, they must be able to exchange confidential information and, what is more, to compare notes about regulated entities that operate in more than one jurisdictions. Second, they must adopt the same, or similar, standards and principles so as to ensure that regulation creates conformity and does not become of itself a source of divergence.
- E. How do these desiderata translate into specific requirements for audit regulation? Let me start by commenting on the second issue first. The exchange of information about regulated entities and the ability to ‘compare notes’ are activities that require planning, legal assurance, and explicit agreements. The ways in which information exchanges are prompted, their extent and their limits, the use to which information derived from a fellow regulator is put, are issues that have to be agreed upon, offering the definite framework of exchanges, before exchanges can actually take place in a systematic way. Cooperation in information exchange can take either a bilateral or a multilateral form, the multilateral being harder to put together, but more efficient once in place. An international initiative sponsored by

major audit regulators around the world is already under way with the immediate goal of creating appropriate conditions for regulatory cooperation. This initiative was launched in a London meeting last month.

- F. The adoption of uniform standards is the other major issue in the present landscape. Thankfully this is an area where a lot of effort has already been invested over the past years and work does not have to start from zero point. The body of International Standards of Audit is already available and can clearly serve as the focal point for international convergence. I do not think I have to underline in front of this audience the evident benefits of the adoption of uniform standards of audit around the world. The benefits promise to be extensive. Comparability of economic outcomes is mainly the result of the adoption of uniform accounting standards. Comparability of the certification of the quality and the credibility of the economic outcomes is the result of uniform audit standards. Investors, as well as all users of capital markets will reap this benefit.

International Standards and the Public Interest

- G. It is therefore argued that international standard-setting is tantamount to the production of an international public good. The choice of persons who undertake this task, the process by which these standards are set, the process by which they are evaluated and renewed, these are all subject to public interest consideration. This is where we come to the role of public interest oversight, and the tasks of the PIOB, which I have the honor to chair.

- H. Let me fill in a bit of recent history. A few years back IFAC took the initiative to reform its processes and its goals, changing itself from a professional body to a public interest organization. The reform encompassed proposals that involved a strengthening of the independence of standard-setting committees, a compliance panel, the creation of a public interest oversight body. International regulators and the World Bank had also been concerned for some time about the need for high quality and homogeneous standards for audits and other aspects of accounting practice. Thus, a world cooperative venture was born. The three international regulatory organizations – IOSCO, the Basel Committee, IAIS – and the World Bank formed an alliance of world regulatory opinion and entered into dialogue with IFAC about

its reform process. The fundamental element in the reform of IFAC as negotiated and agreed upon by the world regulators was the creation of a public interest oversight body: the PIOB. The PIOB was conceived as a body made up of people who were not accounting professionals or practitioners but had a public interest record and a capability to understand the issues of public interest in the formulation of accounting standards. In terms of broad goals, the PIOB is conceived as a Body that will exercise comprehensive oversight over all those activities of IFAC that have a public interest aspect. It will seek to ensure that these activities are indeed undertaken and carried out in the public rather than private interests.

- I. The PIOB is in the ninth month of its operation, and is gradually working towards an operational definition and implementation of public interest policy in the area of international standard – setting. Our oversight of selection of members, process and the determination of priorities is now being developed. We certainly understand and underline the value of due process, transparency, high quality of principles-based standards, and respect of user needs. We also appreciate the fact that the high quality of standards is necessary but not sufficient for the production of high quality audits. The latter result which is the broad desideratum reform activity – the high quality audit – depends on other factors as well: the quality of corporate governance, the effectiveness of the regime for corporate disclosure, the intensity and quality of enforcement effort by national audit regulators. In acknowledging the role of all these other factors, we at the PIOB acknowledge the necessity of maintaining very close liaison with the work done by other regulators, and especially audit regulators around the world. Thus, our agenda includes this mission of liaison and coordination.
- J. I would like to conclude my remarks by observing that there are many signs that make me optimistic about the mission that we have undertaken. The consensus and the intensity of involvement of the world regulatory community, the professionalism and commitment to public interest that I see in the leadership of IFAC, the broad support that our public interest mission has drawn from a variety of quarters, are all sources of optimism. It is my hope that we will be able to fulfill expectations in that very positive climate of cooperation and forward looking reform.