Principles for Auditor Oversight

A Statement of the Technical Committee
of the
International Organization of Securities Commissions

October 2002

Introduction[1]

1. Investor confidence is fundamental to the successful operation of the world's financial markets. That confidence depends on investors having credible and reliable financial information when making decisions about capital allocation.

2. The objectives of securities regulation include the protection of investors; ensuring that markets are fair, efficient, and transparent; and the reduction of systemic risk. In pursuit of these objectives, in the area of reporting to investors, there should be full, timely, and accurate disclosure of financial results and other information that is material to investors' decisions. Full and fair disclosure is essential to investor protection, enhances investor confidence, and promotes market liquidity and efficiency.

3. Independent auditors play a critical role in enhancing the reliability of financial information by attesting as to whether the financial statements prepared by management fairly present the financial position and past performance of the public enterprise in compliance with accepted accounting standards.

4. Effective oversight of the accounting profession and of independent audits is critical to the reliability and integrity of the financial reporting process. The Technical Committee of the International Organization of Securities Regulators ("IOSCO") has developed a list of general principles for oversight of audit firms and auditors that audit financial statements of companies whose securities are publicly traded in the capital markets (hereinafter referred to as "auditors").

5. At the present time, a variety of systems for auditor oversight exist among the IOSCO Technical Committee members. In many cases, these existing systems are undergoing review as a result of financial reporting failures, weaknesses discovered in self-regulatory structures, changes in public expectations, requirements of new legislation, or for other reasons. One jurisdiction has reported that firm-on-firm peer review under self-regulation failed and that new legislation has directed the creation of an auditor oversight body, independent of the accounting profession, with strengthened powers for rulemaking, inspection and disciplinary authority. A number of other jurisdictions have announced that changes will be made in auditor oversight processes and structures. The Technical Committee believes that there is a growing consensus internationally as to the benefits of an auditor oversight system that is not based exclusively or predominantly on self-regulation.

6. The principles set forth herein are intended to assist securities market regulatory authorities, and other authorities with responsibility for auditor oversight, in developing and enhancing regulatory structures for auditor oversight in the wide range of different legal, business and professional environments that exist in IOSCO member jurisdictions. The Technical Committee encourages IOSCO members to work towards implementing these principles in their own jurisdictions. In jurisdictions in which the securities regulator does not have primary responsibility for auditor oversight, it will nevertheless

[1] This report was endorsed by the Presidents Committee during its 16 October 2003 meeting.

have an interest in ensuring that the oversight system is consistent with maintaining and enhancing investor confidence in published financial statements.

Principles for auditor oversight

7. Oversight of auditors can occur in several ways, including within audit firms, by professional organizations and public or private sector oversight bodies, and through government oversight. In addition, oversight may be provided by supervisory boards and audit committees representing investors in matters relating to individual companies.

8. Within a jurisdiction, auditors should be subject to oversight by a body that acts and is seen to act in the public interest. While the nature of an auditor oversight body and the process through which it carries out its activities may differ among jurisdictions, IOSCO believes that effective oversight generally includes the following:

I. A mechanism to require that auditors have proper qualifications and competency before being licensed to perform audits, and maintain professional competence. A mechanism also should exist to withdraw authorization to perform audits of publicly traded companies if proper qualifications and competency are not maintained.

   IOSCO believes establishing qualification requirements and requiring maintenance of professional competency should improve the quality of auditing. Moreover, the risk that authorization can be revoked for failure to have or maintain the necessary qualification should be an incentive for compliance and adherence to auditing standards.

II. A mechanism to require that auditors are independent of the enterprises that they audit, both in fact and in appearance. Effective standards, regular assessments, and regulatory oversight generally increase the likelihood that independence is maintained.

III. A mechanism should exist to provide that a body, acting in the public interest, provides oversight over the quality and implementation of auditing, independence, and ethical standards used in the jurisdiction, as well as audit quality control environments.

IV. A mechanism should exist to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body. Such an auditor oversight body must operate in the public interest, and have an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding that is not under the control of the auditing profession, to carry out those responsibilities.

An auditor oversight body should establish a process for performing regular reviews of audit procedures and practices of firms that audit the financial statements of listed public companies. This oversight process may be performed in coordination with similar quality control mechanisms that are in place within the audit profession, provided the oversight body maintains control over key issues such as the scope of reviews, access to and retention of audit work papers and other information needed in reviews, and follow-up of the outcome of reviews. Reviews should be conducted on a recurring basis, and should be designed to determine the extent to which audit firms have and adhere to adequate quality control policies and procedures that address all significant aspects of auditing. Matters to be considered include:

a. Independence, integrity and ethics of auditors
b. Objectivity of audits
c. Selection, training, and supervision of personnel
d. Acceptance, continuation and termination of audit clients
e. Audit methodology
f. Audit performance, that is, compliance with applicable generally accepted auditing standards
g. Consultation on difficult, contentious or sensitive matters and resolution of differences of opinion during audits
h. Second partner reviews of audits
i. Communications with management, supervisory boards and audit committees of audit clients
j. Communications with bodies charged with oversight over the financial reporting process, for example, on matters such as regulatory inquiries, changes in auditors, or other matters as may be required
k. Provisions for continuing professional education.

An auditor oversight body also should address other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients, consulting and other non-audit services, and other matters as deemed appropriate.

V. An auditor oversight body should have the authority to stipulate remedial measures for problems detected, and to initiate and/or carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.

VI. In relation to companies operating or listing on a cross-border basis, IOSCO members are encouraged to provide each other, whether directly or through coordinating with the auditor oversight body in their jurisdiction, with the fullest assistance permissible in efforts to examine or investigate matters in which improper auditing may have occurred and on any other matters relating to auditor oversight. Members are also encouraged to explore approaches to enhance cooperation among jurisdictions.