



Plenary 2

Accounting and Auditing – An International Perspective

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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 necessarily represent PIOB policy, unless explicitly stated.

The assurance of high quality financial reporting is a generally accepted and strongly needed objective. The assurance of high quality audits is an equally generally accepted and strongly required objective. In fact the two are mutually reinforcing parts of the more general goal 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 that standards in a active and growing world market require. With respect to ISA the process is still at a much earlier stage, and IOSCO is now starting to consider their endorsement. I would like to offer some thoughts on the basis on which such an endorsement could be offered.

I would like to refer to some very basic facts about the present setup of international standard setting in the area of audit. For some years this activity has taken place under the aegis of the International Federation of Accountants (IFAC). Since 2005, and on the basis of an agreement of several world regulatory organizations, including IOSCO as a more prominent member, with IFAC an independent oversight body was established. The PIOB's task is to oversee standard setting activities and ensure that they are 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 that is set down ex ante, furnishing a set of objectives and describing a process which must be followed by auditors. As all regulatory tools which aspire to general application, international standards of audit 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 practice. The latter purpose is of course also a regulatory

tool practiced now 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 field of application is different from 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 it is also required that the standard setters and the standard setting process must command credibility and excellent reputation. It follows that a great deal of our work has been devoted – as has been our mandate – 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.

The composition of standard setting bodies has been shifting very considerably over the last two years towards a stronger presence of non – practicing auditors, towards a wider regional representation, and towards a better representation of small and medium sized practices. The better representation must of course be coupled with a search for high quality individuals who have 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.

The adherence to due process is an equally important part of the standard setting task. One of the first tasks of the IOB was to approve an enhanced revised due process for standard setters and now our agenda places a great deal of emphasis on ensuring that due process is followed. This is all about the responsiveness of standard setting to the needs and perceptions of various stakeholders around the world, with primary emphasis on investors, regulators, and corporate users. Following due process does not mean of course that standard setting can satisfy all viewpoints. International standard setting experience suggests 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 that there is a constant tension between ‘principles’ and ‘prescriptive rules’ in the making of standards. A variety of stakeholders press for ‘prescriptive rules’ in order to create legal certainty and administrative clarity. This is tension that is well known to security regulators. If one has in mind international convergence, principle based standards must be pursued. Yet, it is well known that too wide and too high level principles can compromise convergence at the level of regulatory, or audit, practice. Therefore, the discovery of 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. These are not easy challenges but neither are they insurmountable. IOSCO has wide and valuable experience in this area as a formulator of world regulatory principles and standards itself.

Let me finally offer my opinion as to which objectives an IOSCO assessment of audit standards could look for. The content, the format, and the degree of prescriptiveness of standards furnishes a definite class of criteria. The adherence to due process, and substantially the responsiveness of the standard setters to various stakeholders, makes up another class of criteria. The alignment of standards to new investor needs, and to emerging regulatory requirements suggests a final class of criteria. This latter item must however become well defined and remain mindful of the balance of ‘principles’ versus ‘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 among a large variety of constituencies. There is very little difference in goals, and the new architecture of international standard setting now includes a good number of safeguards. This consensual juncture augurs well for the strategy which looks towards achievement of high quality financial reporting and its salutary effects on market integrity.