



**The Value of High Quality Audits
and the Importance of Funding an
Independent Multi-stakeholder International
Standard-setting Structure**

Introduction

Professional accountants serve a critical role in the global financial reporting ecosystem, both in the preparation of a company's financial information in accordance with the applicable financial reporting framework and in the performance of auditing and assurance services over a company's financial and non-financial information. Financial statement users, including investors, other capital providers, regulators, and stock exchanges, are the direct beneficiaries of high quality work of professional accountants. The quality of their work is facilitated by high quality, internationally-adopted standards, particularly:

- Ethics standards for professional accountants, including auditor independence requirements issued by the International Ethics Standards Board for Accountants (IESBA); and
- Auditing, assurance and quality control standards issued by the International Auditing and Assurance Standards Board (IAASB).¹

The global business environment today in which companies and professional accountants operate continues to evolve and increase in complexity and so too do the needs of investors and others who rely on high quality reporting and assurance services. The global financial reporting ecosystem is built upon high quality international audit and ethics standards adopted across jurisdictions, so that investors, regulators, stock exchanges, and others can have confidence in the quality and reliability of information they use for capital allocation decisions.

The development of high quality audit and ethics standards based on independent, extensive, and inclusive due process that allows for input from all stakeholders and is subject to appropriate oversight, is critical to that confidence. High-quality standards are a public good and serve to increase public confidence in the reliability of information provided by the financial reporting ecosystem.

¹ We refer to the standards issued by the IAASB and the IESBA collectively as "audit and ethics standards".

Importance of high quality international audit and ethics standard setting

The international audit and ethics standard-setting system plays a vital role in the global financial reporting ecosystem.² In particular, the IAASB and the IESBA (collectively, the Standard-Setting Boards (SSBs)), with oversight from the Public Interest Oversight Board (PIOB), serve the public interest by developing high-quality standards that enhance the quality and consistency of the services provided by professional accountants, which in turn contributes to public trust and confidence in the global financial reporting ecosystem.³

Further, the continually-evolving environment in which external reporting and assurance services operate demands that the international audit and ethics standard-setting system be agile and responsive to meet the public interest.

Importance of diversified funding of the international audit and ethics standard-setting structure

The Monitoring Group (MG) Recommendations acknowledge the importance of sufficient financial resources to support the recommended standard-setting structure. This includes long-term funding commitments that will foster the independence and continuity of the standard-setting activities throughout the structure itself for the PIOB as well as the SSBs. This will enable the development of high quality standards from an inclusive and comprehensive consultation process with stakeholders globally, supported by public interest oversight, and widespread adoption of the standards.

The long-term goal is to establish a diversified funding model for the standard-setting structure which will include diversified funding of the PIOB. Achieving diversified funding can support the objectives in the MG Recommendations which is to reinforce the consideration of the public interest within the standard-setting process and throughout the full standard-setting cycle, including through appropriate independent oversight of the IAASB and IESBA's standard setting process.

The PIOB plays a critical role in the international audit and ethics standard-setting system as the global independent oversight body that seeks to facilitate and support the quality and public interest focus of the international audit and assurance, and ethics standards developed by the standard-setting boards. To ensure the independence and credibility of the PIOB as that oversight body, both in fact and

² The three-tier system that results in the development of high quality standards is described in Monitoring Group, Strengthening the International Audit and Ethics Standard-Setting System, available at https://www.iosco.org/about/monitoring_group/pdf/2020-07-MG-Paper-Strengthening-The-International-Audit-And-Ethics-Standard-Setting-System.pdf.

³ See, e.g., Defond and Zhang, "A Review of Archival Auditing Research," *Journal of Accounting and Economics*, 2014.

appearance, the recommendations imply that there should be sufficient financial resources from diversified sources for it to carry out its responsibilities. There is now an opportunity to further enhance the independence and credibility of the PIOB through further diversification of funding that is independent from the accountancy profession. The independence and public interest responsiveness of the standard-setting system will be further enhanced by diversification of funding for the SSBs as well.

Stakeholders who benefit from the work done by a strengthened international audit and ethics standard setting system

Stakeholders in the global financial reporting ecosystem benefit from the high quality of work performed by the IAASB and IESBA as well as from the oversight provided by the PIOB. The direct beneficiaries of the high-quality international audit and ethics standard setting system are investors, regulators, stock exchanges, national standard setters, and auditors.

Investors

Globally, investors rely on high quality financial reporting that is subject to the performance of assurance services to enhance investor confidence that the information is materially correct and complete. Independent third-party assurance over financial and non-financial information can support the information needs of investors.⁴

Consistent performance of high quality assurance promotes investor confidence in the quality of financial reporting and the integrity of financial markets which leads to a reduction in both the cost of equity⁵ and the cost of debt.⁶

High quality international audit and ethics standards, therefore, directly affect an investor's ability to make more informed capital allocation decisions and supports more efficient capital markets and capital flows.

⁴ Commenters on the [Consultation paper and comment letters: Sustainability Reporting](#) by the IFRS Foundation Trustees, such as Blackrock, CFA Institute and The Investment Association, note that some investors seek assurance on some portions of sustainability information provided by issuers.

⁵ Knechel, Krishnan, Pevzner, Shefchik and Velury, "Audit Quality: Insights from the Academic Literature," *Auditing: A Journal of Practice and Theory*, 2013.

⁶ Blackwell, Noland and Winters, "The Value of Auditor Assurance: Evidence from Loan Pricing," *Journal of Accounting Research*, 1998.

Regulators, stock exchanges, and national standard-setters

Regulators, stock exchanges, and national standard-setters directly benefit from widely accepted high-quality global audit and ethics standards. As more than 120 jurisdictions around the world have determined, adopting global audit and ethics standards benefit them because they do not have to invest their own resources in developing auditing, ethics and independence standards for their own individual use. As a result, the global cost of a high quality standard-setting system is significantly reduced since the process does not need to be duplicated in its entirety in each individual jurisdiction. In addition, global audit and ethics standards adopted across jurisdictions increase audit quality and promotes greater global comparability of financial and nonfinancial information.

Regulators and the stock exchanges they oversee rely on the high quality assurance services which is predicated on high quality audit and ethics standards as part of their monitoring activities. Monitoring activities performed by regulators cannot be consistently performed if the standards are not of sufficiently high quality.

Funding the International Audit and Ethics Standard Setting System

An independent standard-setting system that develops high quality principles-based standards, developed in the public interest by standard setters safeguarded from undue influence is critical to ongoing economic development. However, for the system to fully serve the public interest, financial responsibility must be shared by all stakeholders, including investors, regulators, stock exchanges, national standard-setters and auditors. The effective functioning of the global financial reporting ecosystem depends on diversified and continuous funding sources to support the international audit and ethics standard-setting system.

Academic studies have demonstrated that stakeholders in the financial reporting ecosystem benefit from a reduction in both the cost of debt and the cost of capital when companies' financial reporting is subject to high-quality independent audits based on high-quality auditing standards. This benefit is realized particularly in jurisdictions with stronger institutions governing investor protection and disclosure standards, resulting in lower cost of equity financing.

For illustrative purposes, a reduction of the cost of debt and cost of capital, in the aggregate, by a single basis point would result in a net economic benefit globally of:

Global Net Economic Benefit of a 1 Basis Point Reduction in the Cost of Capital	
Global Market Capitalization (A)	\$109.21 USD trillion ⁷
Cost of Capital Reduction (B)	1 basis point
Net economic benefit (A)*(B)	\$10.9 USD billion
Operating costs of the PIOB ⁸	Approximately \$3 USD million
Operating costs of the SSBs	Approximately \$20 USD million

As can be seen from the above table, the benefit to stakeholders of a single basis point reduction exceeds the cost of operating the standard-setting system by a multiple of almost 500 times! Further, this is an extremely conservative illustration because academic studies across various jurisdictions conclude that the cost of debt alone is reduced by a range of 47⁹ - 56¹⁰ basis points when comparing the cost of debt of an audited versus unaudited company. Accordingly, the Monitoring Group calls on all stakeholders, who individually and collectively benefit from the high quality work of the IAASB, IESBA and PIOB, to financially support the international audit and ethics standard setting system. An independent, inclusive multi-stakeholder standard-setting structure must balance the intellectual contributions and benefits received from involvement in the standard-setting process with financial contributions needed to diversify the funding of the structure in the public interest.

⁷ World Federation of Exchanges Full Year 2020 Market Highlights: "In November 2020, global market capitalization passed the 100 USD trillion mark for the first time, ending the year at 109.21 USD trillion, up 19.7% when compared with the end of 2019."

⁸ Operating costs represent a forecast subsequent to the implementation of the MG Recommendations and normal travel to execute against their respective mandates.

⁹ Huq, Hartwig, and Rudholm; "Do Audited Firms Have A Lower Cost of Debt?" *International Journal of Disclosure and Governance*, 2022.

¹⁰ Kim, Simunic, Stein, and Yi; "Voluntary Audits and the Cost of Debt Capital for Privately Held Firms: Korean Evidence;" *Contemporary Accounting Research*; 2011.