



Regulation of Financial Reporting and Auditing

A Global Perspective

**Susan Currie, Financial Reporting Council
NASBA International Forum
Orlando, October 2012**



Introduction

- Regulation of financial reporting and auditing – international position
- About the FRC
- Criticism of current arrangements for financial reporting and audit
- Regulatory responses and proposals
- Evidence for audit quality
- Implications for the profession
- Questions



What is financial reporting and auditing regulation?

- Setting of rules for financial reporting by companies
- Setting of rules for the auditing of companies' financial statements
- Enforcement of those rules
 - Oversight
 - Monitoring
 - Discipline



Who sets the standards?

- International Financial Reporting Standards (IFRS) developed by the International Accounting Standards Board (IASB)
- Aim is to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles



Who sets the standards? (2)

- Most major economies have either adopted IFRS for listed companies or have a timetable for adoption
- International Standards on Auditing (ISAs) - set by IFAC via the International Auditing and Assurance Standards Board (IAASB)



Who sets the standards? (3)

- ISAs, or national standards based on ISAs, have now been adopted in most major economies
- National accounting and auditing standard setters remain, feeding into international standard development and fulfilling specific local requirements



Who enforces the rules?

- Enforcement of financial reporting and auditing standards is carried out by national regulators in accordance with local laws



Who enforces the rules? (2)

- There are a variety of different models for this national regulation:
 - Government only
 - Government with independent or semi-independent agency
 - Government with professional body
 - Government with agency and professional body



About the FRC

- The UK's independent regulator for corporate governance and reporting
- Setting of auditing, accounting, actuarial and ethical standards
- Responsible for the UK Corporate Governance Code



About the FRC (2)

- Oversight, monitoring and discipline functions for corporate reporting and audit
- International influencing
- Our focus is on matters of significant public interest



International co-operation

- There is increased co-operation between national regulators
- EU group on the enforcement of financial reporting standards (EECS)



International co-operation (2)

- Joint audit inspections
- International Federation of Independent Audit Regulators (IFIAR)



Criticism of current arrangements

- Company annual reports are longer than ever but are increasingly filled with “boilerplate” disclosures
- Investors want more information about risks and the business model in particular



Criticism of current arrangements (2)

- There has been criticism of IFRS:
 - Valuation of assets can be unclear
 - Encourages box-ticking ahead of professional judgement
- Concerns about the audit report, in particular the “pass/fail” model



Government and regulatory response

- In the US a number of PCAOB concept releases:
 - Auditor rotation
 - Auditor reporting model
 - Auditor independence



Government and regulatory response (2)

- In the UK reports from the Treasury Select Committee and House of Lords
- In the European Union a Green Paper on audit, and subsequent far-reaching proposals



Key European Union proposals

- Compulsory auditor rotation
- The largest auditors to become audit-only firms
- Prohibition on non-audit services to audit clients



Key European Union proposals (2)

- Audit report to include additional information
- Reduced role for professional bodies in audit regulation
- Stricter rules for oversight and appointment of auditors by audit committees



Common themes

- It is possible to discern two common themes arising from the various inquiries and consultations around the world:
 - The current reporting model is not fit for purpose
 - Auditors demonstrate insufficient professional scepticism



Common themes (2)

- It is possible to discern two common themes arising from the various inquiries and consultations around the world:
 - The current reporting model is not fit for purpose
 - Auditors demonstrate insufficient professional scepticism
- There also remain concerns about market structure and independence



Audit quality - international evidence

- At a recent IFIAR meeting, held in Busan, South Korea, in April 2012, the most commonly noted matters identified in audit inspections included issues related to:
 - Professional scepticism;
 - Group audits;
 - Revenue recognition;



Audit quality-international evidence (2)

- Engagement quality control review;
- Testing of internal controls;
- Auditing accounting estimates;
- Linkage of audit quality to partner remuneration;



Audit quality - international evidence (3)

- Auditor independence;
- The use of auditors' experts; and
- Applying clarified ISAs.



Audit quality - evidence from the UK

- Our most recent round of audit inspections identified the following themes:
 - Compared to previous years, a reduction in the number of audits reviewed which were deemed to need significant improvement



Audit quality - evidence from the UK (2)

- Increased pressure on fees and costs is leading firms to seek efficiency savings; this may risk audit quality
- There is no evidence yet that actions taken by firms to reinforce professional scepticism have had any effect on behaviour
- Deficiencies in the threats and safeguards approach to professional ethics



Implications for the profession

- There is unease in some quarters about the quality of financial reporting, the value of audit and the actions of auditors
- This unease manifests itself as demands for regulatory changes; however the underlying issue appears to be a loss of trust in auditors and the accountancy profession more generally



Implications for the profession (2)

- Auditors around the world can expect to see:
 - Changes to the reporting model
 - Stricter independence rules
 - Action on market structure



Implications for the profession (3)

- A distinguishing feature of the profession is its obligation to act in the public interest – but is this aspiration or reality?
- Regulatory changes may help improve systems and controls, but they cannot in themselves change behaviour



Implications for the profession (4)

- Larger firms should identify root causes of issues common to independent inspection findings and consider effectiveness of own global quality reviews
- The profession as a whole needs to be less defensive and play a role in demonstrating the value of audit



Questions