

## **Chapter 8**

# IFAC, IAASB, IASB, IOSCO, the FSF and the World Regulatory Environment

**Ian Ball**

Chief Executive, International Federation of Accountants

### **8.1 Introduction**

The role of financial information is critical to the effective functioning of capital markets as well as to the operations of organisations, large and small, in all sectors of the global economy.

Organisations in an international context that are central to determining the quality of financial information include the International Federation of Accountants (IFAC) and its audit standard-setting board, the International Auditing and Assurance Standards Board (IAASB), the International Accounting Standards Board (IASB), the International Organization of Securities Commissions (IOSCO) and the Financial Stability Forum (FSF). Together, these organisations shape the financial reporting dimension of the international financial system.

Since its inception in 1977, the International Federation of Accountants' (IFAC's) service to the public has been best reflected in its drive to promote a sound global financial reporting and auditing framework conducive to successful business operations, efficient capital flows, and ultimately economic growth and social stability and well-being. It has and continues to accomplish this through the work of its standard-setting committees – the Ethics Committee, Education Committee, IAASB and Public Sector Committee – as well as through support of the work of the International Accounting Standards Board (IASB), and collaboration with international organisations and regulators, such as

IOSCO. Working together with its 157 professional accountancy organisations (Member Bodies) with 2.5 million accountants in 118 countries, as well as with regional accountancy bodies, IFAC's mission is:

“To serve the public interest, strengthen the worldwide accountancy profession, and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant.”

Globalisation and the growth of transnational companies, combined with large-company business failures, have dramatically changed the environment in which accountants practice and have compelled accounting associations and standard setters to re-examine their roles and responsibilities. IFAC's primary focus in recent years has been threefold:

- to establish a more transparent and relevant standard-setting process;
- to enhance accountants' accountability through quality control and other initiatives; and
- to strengthen its regulatory responsibilities in the international environment. These initiatives and the role of IFAC, as well as the roles and initiatives of IASB, IOSCO and the FSF are described in this article.

## **8.2 The current environment**

As we moved into the new century, the international accounting and auditing profession was facing pressure as never before from users and regulators to prove that it was capable of meeting the expanded demands of the world's capital markets. New questions were being asked and old questions were posed with greater scepticism. Do existing rules on independence ensure auditor objectivity? Should the auditor have a responsibility to report on non-financial information? Does the brand name of an audit firm guarantee uniform standards

of work worldwide? The regulators had also begun to take a greater interest in the internal affairs of firms within the profession and to examine the quality of work produced by professional accountants and auditors.

Government and regulators have been and continue to be responsible for ensuring a sound framework of legislation and regulation at the national level. Historically, the assurance standard-setting and compliance/enforcement responsibilities in most developed economies had been conducted through what was called a “self-regulatory” regime that was managed by accountancy groups themselves, but always implied a level of governmental oversight. However, the traditional self-regulatory role of the profession was being challenged in some countries, and regulators were increasingly taking an interest in the profession’s affairs at the international level. As the profession faced this heightened scrutiny, there was also a growing recognition on the part of users and regulators that a core set of international standards to be followed by the world’s accountants was increasingly necessary.

It is against this backdrop that IFAC, as the representative organisation for the world’s accountants, initiated a series of reforms – working for the first time in close partnership with regulators – to increase confidence that its activities are properly responsive to the public interest and lead to the establishment of high quality standards and practices.

### **8.3 International standard setting**

The international accountancy profession has long recognized the need for an internationally harmonised accountancy framework to meet the increasingly global nature of the world economy. Two bodies in particular – IFAC’s International Auditing and Assurance Standards Board (and its predecessor, the International Auditing Practices Committee (IAPC)) and the International Accounting Standards Board (and its predecessor, the International Accounting Standards Committee (IASC)) – have been responsible for the development of international standards designed to give confidence in financial reporting. In addition, IFAC’s international standards in

ethics, education and public sector accounting contribute to harmonization and their adoption is reinforced through IFAC's Member Body Compliance program and other IFAC initiatives. These are described further below.

## **8.4 IFAC standard-setting initiatives**

The objective of the IAASB, which operates under the auspices of IFAC, is to serve the public interest by setting high quality auditing, assurance, quality control and related services standards and by facilitating the convergence of national and international standards. Like its predecessor organisation, the IAPC, which was formed in the 1970s, it is dedicated to enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in financial reporting and in the global auditing and assurance profession.

In January 2001, the leadership of IFAC agreed to institute a comprehensive review of the membership, organisation and processes of the IAPC. It established a Review Task Force to make recommendations that would ensure that the IAPC met requirements of regulators and other external observers in terms of its efficiency, transparency and credibility as the recognized international auditing standard setter. The report of the IAPC Review Task Force, published in November 2001, made many recommendations for improving the operations of the IAPC and for enhancing public interest oversight. Among these recommendations were changes to the name (to the International Auditing and Assurance Standards Board), changes to its terms of reference, changes to the composition of its membership and a recommendation for greater clarity and transparency about its operating procedures and the status of its pronouncements. As a result of that review process, the new IAASB was established with changes including:

- Expanded membership from 14 to 18 volunteer members, including three public members;
- Meetings open to the public and agendas, background materials and other guidance publicly available through the IFAC website ([www.ifac.org](http://www.ifac.org));

- Agreement to work more closely with national standard setters, particularly with respect to promoting eventual convergence to a single set of global audit standards; and
- Increased technical resources.

As a result of these changes, the IAASB has increased the public's input into its standard-setting processes and, with additional resources and a renewed focus, has been able to address a wider range of auditing and assurance issues, including the development of new audit risk standards, a new assurance framework, new wording for the auditor's report, and updated quality control guidance. The IAASB, through its International Standards on Assurance Engagements (ISAEs), addresses not only matters relating to the reliability of financial statements, but also other areas where the opinion of the independent auditor can add value and credibility to the information provided by directors and management. Most recently, IAASB has developed new quality control standards addressing quality control responsibilities at both the firm-wide and audit engagement levels and a new standard on the auditor's responsibility to consider fraud in an audit of financial statements.

To date, more than 70 countries have indicated that they either have adopted ISAs or noted that there are no significant differences between their national standards and ISAs. ISAs have been translated into more than 20 languages, including French, German, Russian and Spanish. Moreover, the Financial Stability Forum, a consortium of national public sector authorities responsible for financial stability in significant international financial centres, recognized ISAs as one of 12 core sets of standards that must be implemented as part of the improvement of the global financial architecture. The European Commission's proposed adoption of IAASB pronouncements in 2005 will provide further impetus for their global acceptance.

IAASB continues to meet regularly with national standard setters. A Consultative Advisory Group, representing regulators, preparers and users of financial statements, provides ongoing input to IAASB projects and convergence initiatives.

IFAC's Ethics Committee is responsible for the development and updating of the Code of Ethics for Professional Accountants. This Code is applicable to all professional accountants, including those working in

business and industry, and serves as the basis for ethical requirements for professional accountants in each country. It contains guidance relating to professional integrity and, in particular, independence issues.

Other standing committees of IFAC develop standards and/or guidance in the areas of education, financial and management accounting and the public sector.

Beginning in 2003, IFAC's Education Committee issued the first seven International Education Standards. They are designed to achieve global quality and consistency in accounting education. In addition, they serve the public interest by assisting professional accountants in all areas of the economy in meeting the public's expectations of competency.

IFAC's Public Sector Committee (PSC) develops International Public Sector Accounting Standards (IPSASs) and other guidance in an effort to enhance public sector financial reporting, financial management and accountability. More than 20 standards have been issued to date and public sector entities, including sovereign governments, are increasingly adopting these standards or using them as a basis for their own standards. Most recently, the Public Sector Committee External Review Panel completed its study on the PSC's role, activities and governance and made recommendations to enhance the PSC's capacity to develop high quality IPSASs. As this book goes to press, the PSC is in the process of addressing these recommendations.

In addition, two permanent task forces address issues relating to the needs of small- and medium-sized enterprises and developing nations and provide input into international standard-setting processes. Each of these committees and working groups consults widely with users, regulators, national professional bodies and others in developing its ideas and producing final outputs.

#### **8.4.1 IFAC Strengthening Initiatives: Forum of Firms, Compliance Program and 2003 Reforms**

In addition to its efforts to ensure the relevancy and quality of its standards, in recent years IFAC has undertaken other efforts to enhance the quality and consistency of financial reporting and auditing worldwide, to ensure the profession's responsiveness to the

public and to adopt a more active role in the international regulatory environment. This was accomplished in part through the establishment of the Forum of Firms, the IFAC Member Body Compliance Program and more recent reforms affecting IFAC's standard-setting processes.

In January 2001, the Forum of Firms was established to provide a vehicle for firms with an interest in conducting transnational audits to participate in and strengthen IFAC's standard-setting work. Membership of the Forum is open to any firm that has transnational audit appointments or is interested in accepting such appointments and agrees to conform to the Forum's Quality Standards. The Quality Standards require member firms to comply with International Standards on Auditing, in addition to relevant national standards on auditing; comply with the IFAC Code of Ethics, in addition to relevant national codes of ethics; maintain training programs on IFAC standards and relevant international developments; and conduct regular globally directed internal quality assurance reviews to monitor compliance. Twenty-four firms, together responsible for the audit of 95 per cent of the world's stock market capitalization, have joined as provisional members. IFAC works with the Forum through the Transnational Auditors Committee (TAC), an IFAC committee whose members are nominated by the Forum.

The TAC has also considered how it could more directly influence the quality of services provided by firms, and recently undertook several other initiatives aimed at strengthening audit quality.

#### **8.4.2 IFAC Member Body Compliance Program**

IFAC's new Member Body Compliance Program, launched in March of 2004, will further contribute to enhancing the quality of services provided by accountants worldwide. Statements of Membership Obligations (SMOs), covering such areas as audit, ethics, education, quality assurance and investigation and discipline programs, serve as the foundation of the Member Body Compliance Program. The program is designed to encourage and improve member bodies' compliance with the SMOs as well as assist member bodies in the establishment, promotion and implementation of international standards.

The IFAC compliance initiative is significant for two reasons. It will help IFAC to identify barriers and other obstacles to convergence towards international standards. It will also provide member bodies and others with the information necessary to develop action plans in removing barriers to convergence. The program will be based on a process of strict self-assessment and gap analysis. Beginning in late 2004, member bodies are required to report on the extent to which they are meeting their obligations in each of the areas mentioned above. In areas where they are not complying, member bodies will be asked to develop action plans outlining how and when they plan to eliminate identified gaps. Where IFAC member bodies do not have responsibility for these areas (in particular where the responsibility for a function is in the public sector), they will be required to describe how they use their best endeavours to encourage those entrusted with such functions to implement the provisions of the SMOs.

In the interests of full disclosure and transparency, the results of the compliance program will be made public through IFAC's website.

### **8.4.3 IFAC Reforms**

Considering how it can best help accountants worldwide in providing quality services and in meeting their public interest responsibilities, IFAC conducted a self-assessment of its governance activities and regulatory responsibilities in 2003. As part of this process, the IFAC leadership engaged in ongoing dialogue with member bodies, regional accountancy organisations, firms, and regulators from around the world. The result of that effort was a document entitled "Proposals for Reform", which was agreed with the international regulators and unanimously approved by the IFAC Council in November 2003.

The objectives of the reforms, which are in the process of being implemented, are to:

- Increase confidence that IFAC's activities are responsive to the public interest;
- Lead to the development of high quality standards and practices; and
- Help achieve global convergence of standards.

Key aspects of the reforms include the development of a more transparent standard-setting process, particularly with respect to audit and assurance standards, the provision for greater public and regulatory input into that process and ongoing collaboration between the international profession and the regulators. Significantly, the reforms call for the establishment of a Public Interest Oversight Board (PIOB) to oversee IFAC's public-interest activities.

The PIOB, to be established later in 2004, will comprise 10 members selected by the regulatory community. It will focus on IFAC standard-setting activities related to audit and assurance services, independence and other ethics standards. It will also oversee the education standard-setting process and IFAC's member body compliance program.

The reform proposals also included recommendations for strengthening and enhancing the transparency of IFAC's governance, expanding the role of Consultative Advisory Groups in standard-setting processes, and formalizing ongoing collaboration between regulators and IFAC through a regulatory Monitoring Group and an IFAC Regulatory Liaison Group. These changes are already in process.

The reforms should go a considerable way in demonstrating that the international profession is prepared to meet the new demands of the global capital markets and contribute to building confidence in audits and financial reporting in general.

However, as the independent Task Force report (commissioned by IFAC) on *Rebuilding Public Confidence in Financial Reporting* pointed out, to improve confidence in financial reporting, action needs to be taken not only by the international accountancy profession and audit and accounting standard setters, but by all those involved in the financial reporting process. This would necessitate a fundamental commitment to integrity by all those involved. As the Task Force Report stated, improving the credibility of financial reporting requires action at all points along the information supply chain that delivers financial reporting to the market. Those who contribute to financial statements share a common duty to the public to promote the goals of clarity, integrity and transparency. The report, available on IFAC's website ([www.ifac.org](http://www.ifac.org)) makes the following recommendations, amongst others:

- Effective corporate ethics codes need to be in place and actively monitored; such codes should be supported by training.
- Codes of conduct need to be put in place for other participants in the financial reporting process – such as investment analysts and lawyers – and their compliance should be monitored.
- Incentives to misstate financial information need to be reduced, and companies must refrain from forecasting profits with an unrealistic level of precision.
- Audit effectiveness needs to be raised, primarily through greater attention to audit quality control processes.

To provide further support and leadership to those engaged in the financial reporting process, IFAC has also released a study on enterprise governance and is exploring other initiatives to encourage sound and effective governance processes.

## **8.5 About the IASB**

A critical element in the informational financial architecture is the set of financial reporting standards. International Financial Reporting Standards developed by the International Accounting Standards Board provide the worldwide benchmark.

IASB is an independent, privately funded accounting standard setter based in London. The Board assumed its global standard-setting responsibilities in April 2001, from its predecessor body, the International Accounting Standards Committee (IASC), which had been established in 1973. The IASB publishes its standards in a series of pronouncements called International Financial Reporting Standards (IFRSs). Upon its creation, it adopted the body of standards issued by the predecessor IASC. Those standards continue to be designated “International Accounting Standards” (IAS).

The IASB’s 14 mostly full-time members are drawn from auditor, preparer, user and academic backgrounds, and include members who also serve as a liaison with their national standard setters. Providing oversight of the IASB is the IASC Foundation. IASC Foundation trustees are responsible for governance and fundraising for the IASB, while the Board is concerned solely with developing international

financial reporting standards. The IASB meets in public, and seeks wide public input in the development of IFRSs. The Board also uses roundtable discussions and field-testing to further elicit input and measure reaction to new or improved standards, during the public comment period that accompanies the development of new or improved standards.

The Foundation oversees two other bodies: The Standards Advisory Council (SAC) and the International Financial Reporting Interpretations Committee (IFRIC). The SAC has approximately 45 members and provides a forum for organisations and individuals with an interest in international financial reporting to participate in the standard-setting process. Members, who are drawn from government, the regulators, professional services, financial institutions and accounting and investment firms, provide guidance on Board agenda decisions and priorities. The Board is required to consult the SAC in advance of Board decisions on major projects.

The IFRIC tackles accounting issues that are likely to receive divergent or inconsistent treatment in the absence of authoritative guidance, with a view to reaching consensus as to the appropriate accounting treatment. In developing interpretations, the IFRIC works closely with similar national committees. The IFRIC addresses issues of broad importance and concern. The interpretations it develops include newly identified financial reporting issues not specifically addressed in IFRSs.

The IASB's primary objective since its establishment has been to develop high quality, understandable and enforceable global accounting standards. Until now, companies in some jurisdictions have had the option of using international standards, but otherwise the standards the Board develops have not been binding. The IASB works cooperatively with national standard setters around the world to encourage the adoption of global standards, or convergence with them.

In Europe, however, the European Commission has mandated that publicly traded companies will be required to use IASB-developed IFRSs, from 2005, in their consolidated accounts. This trend towards adoption is not restricted to Europe: in a globalised economy, the

move to international standards is gaining steady support, with more than 90 countries worldwide indicating that they will be using or permitting IFRSs by 2005.

In order to meet this deadline and ensure a smooth transition, the IASB has been working to have in place a comprehensive platform of standards by 2004.

## **8.6 IOSCO and its role in the international arena**

An organisation with which IFAC has a long history of working closely is the International Organization of Securities Commissions (IOSCO). With more than 180 members from more than 100 jurisdictions, it is the international organisation for securities regulators. As with the IASB and IAASB, the work of IOSCO has gained increasing visibility in an era of globalisation and corporate failures blamed, at least partially, on corporate governance lapses.

Like the IASB and IAASB, IOSCO is a relatively recent creation. It began life in 1974 as a cooperative association of regulatory bodies based in the Americas. A decade later, regulators from Europe and Asia joined. Organisation members today regulate more than 90 per cent of the world's securities markets.

IOSCO is a cooperative forum for securities regulatory agencies. It does not have the authority to mandate regulations; instead it provides expertise and guidance and develops consistent, enforceable standards of securities regulation for consideration by national member regulators worldwide. Typically, member regulators adopt or promote in whole or part the standards and guidance developed by IOSCO.

IOSCO has two special working committees: one deals with emerging markets, while the other, the Technical Committee, is made up of fifteen agencies that regulate some of the world's biggest markets. The latter's objective is to review and comment on issues like multinational disclosure and accounting and information exchange and enforcement. Through its Technical Committee, IOSCO has provided input into the development of IFAC's new regulatory regime. In

addition, IOSCO participates on the IAASB's Consultative Advisory Group.

In September, 1998, IOSCO published its "Objectives and Principles of Securities Regulation: A Report of the International Organisation of Securities Commissions". In it, IOSCO listed the three core objectives of securities regulation as:

- the protection of investors;
- ensuring that markets are fair, efficient and transparent; and
- the reduction of systemic risk.

The report noted that high quality accounting and auditing standards are critical in meeting these objectives. It encouraged members to ensure several basic practices are in place within their jurisdictions, including requirements for:

- An independent verification of financial statements and compliance with accounting principles through professional external auditing;
- An audit to be conducted pursuant to well-defined and internationally acceptable standards;
- Rules to be in place that are designed to ensure the independence of the auditor; and
- A mechanism for enforcing compliance with accounting and auditing standards.

In October 2002, in specific response to the failure of Enron and other companies, IOSCO's Technical Committee published a set of new international principles on the issues of auditor independence and auditor oversight in relation to listed companies.

In brief, on independence the Technical Committee recommended that external auditors be independent in fact and in appearance, bringing with them objectivity to an environment free of influence. This committee also supported the notion that audit firms themselves develop rigorous internal systems and processes for identifying threats to independence and it listed principles intended to clarify and strengthen the relationship between the audit committee and the auditor.

The committee tackled oversight separately, recommending that jurisdictions worldwide put in place auditor oversight systems not based exclusively or predominantly on self-regulation. IOSCO left open as to who might conduct the oversight function: audit firms themselves, professional organisations, public or private bodies, or government. IOSCO stressed that whatever oversight mechanisms are in place, they must be seen first and foremost to operate in the public interest.

## **8.7 The Financial Stability Forum**

The FSF is an organisation that brings together senior representatives of national financial authorities (central banks, supervisory authorities and finance ministries), international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. It was created in April 1999 by the G-7 group of countries in response to the global economic crisis. Its objective is as stated below:

*“The FSF’s objective is to promote international financial stability through enhanced information exchange and international co-operation in financial supervision and surveillance.”*

In 2003, the Financial Stability Forum noted progress in strengthening public auditor oversight arrangements at the national level, based on the IOSCO principles for auditor oversight issued in October 2002 and urged a stock-taking of national initiatives. It also suggested that the heads of the national oversight arrangements might come together at an appropriate time to exchange experiences and consider policy options.

## **8.8 Conclusion**

The accounting and audit profession is a key element in ensuring that organisations, whether in the private or public sector, operate with proper integrity, openness and accountability – in the interests of all stakeholders and the public generally. At the same time, the responsibility of the regulatory community is to ensure that there are

*IFAC, IAASB, IASB, IOSCO, the FSF and the World Regulatory Environment*

efficient mechanisms in place to ensure that the public interest is paramount in financial reporting. The regulators are right, therefore, to examine the integrity, quality, relevance and value of the profession's activities. Together the regulatory and professional organisations will determine the quality of information available to investors and markets and through that the efficiency of the global economy.