

CHAPTER 7 – INTERNATIONAL

INTRODUCTION

7.1 The scope of the Panel's project included seeking information on issues of audit effectiveness from a global perspective. Several speakers at its October 1999 public hearings and a number of respondents to the survey urged the Panel to consider the effects of globalization. The QPR assessed the work of U.S. engagement teams on audits on which significant auditing work was performed outside of the United States by foreign affiliates of the U.S. audit firm.¹ The Panel also addressed issues of global significance in a number of interviews and other settings. However, the Panel makes no claim of having made a comprehensive review of audit effectiveness on a global basis.

THE GLOBAL ENVIRONMENT

7.2 The business environment continues to reflect the extensive globalization of companies and the markets they serve. Increased cross-border access to the capital markets has helped fuel the international expansion of many businesses. Securities offerings that years ago would have been limited to a company's home country now are routinely extended to multiple jurisdictions. The securities of many companies are traded on exchanges located throughout the world or on sophisticated trading networks that transcend national borders.

7.3 The number of foreign companies that have registered securities in the United States has almost tripled since 1990. In 1999, there were over 1,200 foreign companies from 57 countries reporting in the United States, 10% of which entered the U.S. markets in 1999.² In 1990, there were 434 such companies. (Foreign companies that file financial statements with the Securities and Exchange Commission [SEC] are referred to in this chapter as "foreign registrants.") The securities of many U.S. companies registered with the SEC are traded outside of the United States, and the financial statements of those companies may be filed with non-U.S. regulators. The financial statements of many U.S. companies and foreign companies are available to investors or creditors in numerous countries, irrespective of the jurisdiction that regulates such companies.

INTERNATIONAL ORGANIZATION OF THE ACCOUNTING PROFESSION

7.4 The organization of the accounting profession on an international scale has many facets. Audit firms operate in diverse legal environments, as do their clients. The large audit firms portray themselves as global entities, but in reality their legal organizations vary by jurisdiction.

¹ See "Multi-location Audits" in Chapter 2.

² 1999 annual report of the Securities and Exchange Commission, *SEC Annual Report 99*, p. 76 (U.S. Government Printing Office).

Government regulation of the auditing profession also varies by jurisdiction, as do the profession's self-regulatory structures.

7.5 The standards that affect the profession differ from country to country. Some countries have highly developed standards or rules for accounting, auditing, independence and quality controls over audit firms' practices. Other countries, generally those that are less developed, have not promulgated their own standards.

7.6 There are a number of international organizations that play key roles in the international setting in which the accounting profession is involved. However, in this chapter only the following organizations are discussed:

- IFAC – the International Federation of Accountants. IFAC is an organization of 143 national and regional organizations representing the accountancy profession in 104 countries. The American Institute of Certified Public Accountants (AICPA) is a member of IFAC.
- IASC – the International Accounting Standards Committee. IASC issues international accounting standards.³ These accounting standards are analogous to U.S. generally accepted accounting principles (GAAP) promulgated by the Financial Accounting Standards Board (FASB).⁴
- IAPC – the International Auditing Practices Committee. IAPC establishes international auditing standards.⁵ These auditing standards are analogous to U.S. generally accepted auditing standards (GAAS) promulgated by the Auditing Standards Board (ASB).⁶
- IOSCO – the International Organization of Securities Commissions. This is a global organization of individual country securities regulators. The SEC is a member of IOSCO.
- IFAD – the International Forum for Accountancy Development. This is a group comprising the World Bank, IFAC, large accounting firms, the International Monetary Fund and regulators, among others. Its objectives are discussed later in this chapter.

THE GOAL OF TRANSPARENCY

7.7 Transparency simply means “openness.” It is a concept that calls for full and fair

³ These international accounting standards are referred to as “IASs.” The FASB staff periodically publishes non-authoritative reports on the similarities and differences between IAS and U.S. GAAP.

⁴ In this chapter, the terms GAAP or GAAS are preceded by “U.S.,” “national” or “international” to indicate the body that promulgates these standards.

⁵ These international auditing standards are referred to as “ISAs” or “international GAAS” (see note 4).

⁶ See note 4.

disclosure of information to the constituencies who need that information. An effective and efficient global capital market depends on financial information that is reliable and comparable, regardless of country of origin. For example, the recent Asian crisis raised questions about the effectiveness of accounting and auditing in the affected countries. Critics have cited incomplete financial information, inappropriate or inadequate accounting standards and the inconsistent application of the standards that did exist as factors contributing to the seriousness of the crisis or to the delays in responding to it. Consequently, it has become evident that achieving the goal of “transparency” in the disclosure of information across borders is critical to the orderly development of the global capital markets.

7.8 Transparency is hindered in some areas of the world by a lack of requisite accounting and auditing standards, corporate governance practices and regulation, among other issues. Achieving transparency requires the cooperative efforts of all participants in the capital-raising and financial-reporting processes, including national governments, regulators, the international business community, international lenders and other financial institutions, accounting and auditing standard setters and audit firms.

ACCOUNTING STANDARDS AND REGULATION

Accounting Standards

7.9 Critical to the reliability and comparability of financial information (and therefore its “transparency”) is the establishment of a set of accounting principles and practices that can be accepted internationally. Accounting standards vary significantly from country to country, and in some jurisdictions the standards or rules constituting national GAAP are not oriented to the needs of investors.⁷ Instead they may be driven by tax or other regulatory needs. On the other hand, IASs promulgated by the IASC endeavor to serve the needs of investors.⁸

Regulation

7.10 In the United States the SEC permits foreign registrants to present financial statements prepared in accordance with their home country GAAP (i.e., their national GAAP) or in accordance with standards issued by the IASC.⁹ In either case, foreign registrants are required to quantify and reconcile material differences between their national GAAP or IASs and U.S. GAAP and disclose such differences in financial statements filed with the SEC. The SEC requires that these disclosures be audited.

7.11 In a major effort to seek acceptance of IASs as the benchmark “international” accounting standards, IASC and IOSCO (including the SEC) have been working to develop accounting

⁷ See note 4.

⁸ See note 3.

⁹ In February 2000 the SEC issued for public comment a concept release regarding the use of IAS (Release Nos. 33-7801, 34-42430; International Series No. 1215). The release seeks to identify what important concerns would be raised by acceptance of IAS and asks for comments on whether the SEC should modify its requirement for all financial statements to be reconciled to U.S. GAAP. The release also questions whether having the host country specify the treatment for a topic not addressed by the core standards is workable.

standards for cross-border offerings and listings. In 1995, the IASC announced a program to complete a core set of standards that IOSCO identified as being a reasonably complete set of accounting standards. IOSCO recognized that the initial core set of standards would not address all issues, such as those related to specialized industries or areas where improvements could be made but were nevertheless not critical to the initial core set of standards. IOSCO also recognized that individual jurisdictions might specify required accounting treatments of matters not addressed satisfactorily in IASs.

7.12 By the end of 1999, the IASC had completed the last major component of its core standards project, and both IOSCO and the SEC were engaged in a detailed assessment of the standards. In May 2000, IOSCO recommended that its members permit the use of IAS to prepare financial statements for cross-border filings and listings. However, IOSCO recognized that some of its members might require reconciliation for certain items.

7.13 Because many of the IASC's standards deal with complex issues in considerable detail, they will represent a significant change for some companies that adopt them. Transnational harmonization (or complete convergence) of accounting standards is still evolving and likely will continue for some time.

7.14 In 1998, IOSCO endorsed a set of disclosure standards for the *non-financial statement* portions of a disclosure document. These standards cover fundamental disclosure topics such as the description of the securities issuer's business. The SEC recently revised its foreign private issuer integrated disclosure system to incorporate fully those international disclosure standards, effective September 30, 2000. At that time, except for financial statements, disclosures in offering documents should be substantially equivalent, regardless of the jurisdiction involved.

International Accounting Standards Committee

Structure

7.15 In December 1999, the current IASC Board adopted a proposal to make several significant structural changes so that it can better meet the needs for accounting standards acceptable in most areas of the world.¹⁰ A key change is that the current part-time board will be replaced by a new autonomous board of 14 individuals, 12 of whom will be full-time. The most important board membership qualification is technical expertise. The new board is expected to commence its activities in 2001.

7.16 In applying IASs, questions may arise regarding the appropriate accounting for transactions that are not specifically covered by the standards. The IASC has (and will continue to have under its revised structure) a Standing Interpretations Committee (SIC), which is a vehicle for issuing timely guidance on international GAAP issues, similar to the EITF.¹¹ If an

¹⁰ The new structure adopted by the current IASC Board provides for a group of 19 trustees having diverse geographical and functional backgrounds. The trustees will appoint members of the new IASC Board, the Standing Interpretations Committee and a new Standards Advisory Council. In May 2000, the IASC Nominating Committee made up of seven members headed by SEC Chairman Arthur Levitt announced the selection of the initial trustees, including as their Chairman, Mr. Paul A. Volcker, former chairman of the U.S. Federal Reserve Board.

¹¹ EITF refers to the Emerging Issues Task Force of the Financial Accounting Standards Board.

issue is not addressed by the SIC, preparers may look to their national GAAP for analogous guidance, or regulators may impose other alternatives.¹² This has the effect of permitting a variety of alternatives in the absence of specific guidance. Thus, SIC has a significant challenge in establishing the priorities for dealing with issues that are not addressed by the core set of standards.

Convergence of Accounting Standards

7.17 Many factors may influence how and to what extent standard setters and regulatory authorities are willing to converge on a single set of global accounting standards. However, regardless of whether individual countries adopt the IASC's standards, retain their own standards or select other standards, market pressures likely will encourage convergence over time.¹³ Countries that elect to participate in the convergence of accounting standards may do so in different ways. For example, some countries may:

- Adopt IASs nationally
- Permit, but not require, compliance with IASs as an alternative to national standards
- Not allow certain options permitted by IASs or require additional disclosures
- Adopt IASs piecemeal

7.18 The IASC realizes that identifying and dealing with departures from its standards by preparers (i.e., the enforcement of its standards) will be an important element of the ultimate acceptance of its standards. The leadership efforts of the major accounting firms and IFAD may prove helpful in this regard.

AUDITING IN THE INTERNATIONAL ARENA

International Auditing Standards

7.19 Since the late 1970s, IFAC has led the effort to establish global auditing standards. IFAC formed the International Auditing Practices Committee to establish international auditing standards (international GAAS). IFAC determines membership on IAPC based on candidates' qualifications and with an eye on geographical representation, among other factors. The AICPA

¹² Where the measurement principles of U.S. GAAP and IAS are the same, but U.S. GAAP have interpretive guidance, the SEC staff may expect registrants to use that additional guidance in implementing IAS. For example, in determining when the equity method of accounting should be applied under IAS 28, *Accounting for Investments in Associates*, the SEC staff has stated that indications of significant influence should include those cited in U.S. GAAP in FASB Interpretation No. 35, *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock*.

¹³ The Panel recognizes that convergence solely to promote uniformity might not result in the highest-quality accounting standards, and it believes that policy makers, standard setters and investors need to be cognizant of this fact.

has been represented on IAPC since its inception, and its representative has chaired IAPC several times. The immediate past chair of the IAPC was the AICPA's representative.

7.20 Historically, IAPC has been constrained by limited staff and research resources and the wide geographical dispersion of its members. IFAC's member organizations approved a significant dues increase in 1999 that was allocated to IAPC's activities. Since then, a new technical director and additional technical managers have been hired.

7.21 IAPC reviews its agenda and discusses important projects with a consultative advisory group of public interest organizations. This process has been in effect since 1994. The consultative group members include IOSCO, the European Commission and the Basel Committee on Banking Supervision.

7.22 IFAC's member organizations endeavor to implement IAPC standards in their own environments, albeit country-specific auditing standards generally govern the work of auditors in their own country. For example, in the United States U.S. GAAS established by the ASB govern the work of auditors, notwithstanding the AICPA's membership in IFAC.

7.23 IAPC has endeavored to establish a comprehensive core set of auditing standards. It made significant progress toward that end when it issued a codified core set of international auditing standards in 1994. To date 34 countries have adopted IAPC's international auditing standards, and another 35 countries have based their national standards on the international standards with no significant differences between their national standards and the ISAs.¹⁴ In addition, the European Commission is studying whether the European Union should adopt ISA.

7.24 Similar to efforts to gain regulatory acceptance of international accounting standards, IOSCO and IAPC are in discussions with respect to IOSCO's endorsing IAPC's standards. The process for endorsing the international auditing standards is expected to proceed once IOSCO has completed all of its work on international accounting standards.

7.25 The SEC requires that the financial statements of foreign registrants be audited in accordance with U.S. GAAS and that auditors comply with U.S. standards for auditor independence.¹⁵ The SEC accepts an auditor's report prepared in accordance with the requirements of the auditor's national GAAS or international auditing standards issued by IAPC provided that the report includes a statement that the audit also was conducted in accordance with U.S. GAAS.¹⁶ The SEC recently indicated that qualifying language in auditors' reports such as "substantially similar" or "similar in all material respects" to U.S. GAAS is no longer acceptable.

7.26 The breadth and quality of auditing standards vary from country to country. Regulators'

¹⁴ As reported by IFAC.

¹⁵ For example, see General Instruction E(c) to Form 20-F, an SEC form used for registration and annual reporting by foreign issuers under the Securities Exchange Act of 1934.

¹⁶ The ISAs (see note 5) are similar in concept to U.S. Statements on Auditing Standards (SASs). The staff of the AICPA periodically publishes a non-authoritative analysis of the ISAs, identifying portions of the ISAs that require procedures and documentation beyond those required by U.S. GAAS or that may be in conflict with U.S. auditing standards.

requirements also vary from one jurisdiction to the next. Consequently, one set of “international” standards that could serve as minimum benchmarks for auditors regardless of domicile would be especially useful when an entity’s financial statements are used by investors outside of the country where the entity is domiciled. Consistency in the quality of assurances provided by audits would enhance the efficiency of cross-border financing and help promote a global marketplace for capital.

Other Aspects of Audit Effectiveness Internationally

7.27 As in the United States, other elements of the “system” play a major role in ensuring the reliability of information. Aside from government regulation, the accountancy profession’s efforts at self-governance are an essential part of that system. IFAC endeavors to be a catalyst in promoting practice monitoring and appropriate professional standards, such as quality control standards and ethics standards (including auditor independence). Similarly, IFAC endeavors to promote higher educational standards for the accountancy profession, since the educational systems and consequently the level of technical skills and competencies differ among countries. IFAC has made substantial progress over the years in these endeavors. However, it has been constrained by jurisdictional issues, the stage of development of the profession in specific countries, and its limited financial and other resources.

Recent Changes to SECPS Membership Requirements

7.28 In recognition of the increase in the number of foreign registrants that file audited financial statements with the SEC, in November 1999 the SEC Practice Section (SECPS) of the AICPA changed its membership requirements for member firms associated with foreign firms that audit financial statements of foreign registrants. The changes apply to the foreign offices of international firms as well as any firm outside the United States that is a member of, correspondent with, or similarly associated with an international firm or international association of firms with which the SECPS member is associated.

7.29 The first change, sometimes referred to as the “gatekeeper” provision, requires a limited review of most foreign registrants’ filings by a filing reviewer, that is, a person or persons knowledgeable about U.S. GAAP and U.S. GAAS, as well as about the U.S. independence rules and SEC regulations. The required procedures include discussions with the engagement partner and documenting the results of the procedures performed. Prior to this change, many of the large firms already had such a process, but some firms limited it primarily to initial public offerings and certain other registration statements.

7.30 The second change calls for enhanced inspection procedures, for example, a review of a sample of foreign registrants’ audits that were performed by foreign associated firms. The qualifications of an inspection reviewer are similar to those of a filing reviewer. Prior to this change, many of the large firms already performed internal inspections of foreign offices, but not always on a recurring basis or specifically directed at foreign registrants.

7.31 The “gatekeeper” provision is aimed at the audits of foreign registrants. The inspection procedures, however, also embrace audits of foreign affiliates of U.S. registrants. Thus, a firm’s

global audit practice of both domestic and foreign SEC registrants will now be subject to internal inspection.

7.32 The Panel believes that these changes are appropriate and will serve to improve both financial reporting by foreign registrants and audit quality.

IMPLEMENTATION OF INTERNATIONAL STANDARDS

7.33 Establishing accounting standards internationally appears to the Panel to be progressing at a reasonable pace. But, lagging behind standard setting is the proper application of the standards by the financial reporting community. In its concept release on the use of IAS, the SEC noted that:

...while the accounting standards used must be high quality, they also must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied, and that issues and problematic practices are identified and resolved in a timely fashion. Elements of this infrastructure include:

- effective, independent and high quality accounting and auditing standard setters;
- high quality auditing standards;
- audit firms with effective quality controls worldwide;
- profession-wide quality assurance; and
- active regulatory oversight.¹⁷

7.34 The former Vice President and Controller of the World Bank observed:

[IASC and IFAC] are . . . excellent standard setters but without an effective compliance mechanism, commitment or responsibility. On the one hand they can be seen as useful debating clubs, setting state of the art standards, which, if complied with, could dramatically change the face of the economic earth through transparency; but again, having no teeth to make it happen, other than by benevolently agreed regulatory osmosis. When you keep issuing top class standards, but 80% of your membership does not comply with your own club rules and know full well that nothing in the world can make them do it when they sit in judgment on the next one, you have a problem: tremendous professional satisfaction in a pool of missed opportunities....¹⁸

¹⁷ See note 9.

¹⁸ Jules W. Muis, *Governance, Institutions, Disclosure and Transparency*, an address to the Association of Chartered Certified Accountants, September 1999.

7.35 Of course, as observed earlier in this chapter, achieving transparency requires an enormous effort by all the participants in the capital-raising and financial-reporting processes. This effort entails more than merely moral support from the participants in the processes. Unfortunately, in some cases, the participants themselves may pose the greatest hindrance for transparent reporting. Clearly, strong leadership initiatives are needed.

LEADERSHIP ROLE OF THE MAJOR AUDIT FIRMS

7.36 The major international audit firms have a unique role and franchise in the promotion of uniform accounting standards, financial statement transparency and consistent audit quality around the world. Through their international affiliations and organizational infrastructures, they can promote consistent levels of practice. A widely held view is that their active leadership is critical to achieving the goals of consistent, high-quality financial reporting and auditing throughout the world.

7.37 For example, when the IASs are silent about the appropriate accounting for particular transactions, preparers and regulators may default to their national GAAP or other practices for guidance. Given their international networks, the major international audit firms should be able to put into place policies that will help identify such transactions and promote consistent treatment of similar items in similar circumstances. Furthermore, the firms' active support of the SIC should aid this process by identifying areas of uncertain or differing practice and helping the SIC resolve the conflicts.

7.38 The major firms often have exerted significant influence in the international arena, and they are increasing that influence through cooperative efforts. For example, the Big 5 audit firms decided early in 2000 to identify in their audit reports the basis of GAAP and GAAS employed (i.e., the national or international standards used). Subsequently, in May 2000, the ASB issued a proposal to require a reference in the auditor's report to the country of origin of the accounting principles used to prepare the financial statements and the auditing standards that the auditor followed.¹⁹

INTERNATIONAL FORUM FOR ACCOUNTANCY DEVELOPMENT

7.39 IFAD was formed in 1999 as an initiative of the World Bank and IFAC. Its objectives are to:

- Promote a strong accounting profession throughout the world, especially in developing countries
- Enhance the understanding by developing countries' governments of the value to them of transparent financial reporting

¹⁹ ASB Exposure Draft, *Omnibus Statement on Auditing Standards* – 2000.

- Help harness funds and expertise to build accounting capacity in developing and transitional countries
- Assist in defining expectations about how the accounting profession should carry out its responsibilities to support the public interest in these countries
- Promote the use of IASs as the minimum benchmark for national accounting standards

7.40 IFAD held its first two meetings in 1999 and has held one meeting in 2000 to date. In response to concerns about inconsistent reporting and auditing practices, the seven largest international audit firms proposed an approach to raising and enforcing standards across the world, which IFAD adopted. Implementation will require significant long-term efforts, and the firms have committed themselves to provide a leadership role in that endeavor.

7.41 The approach includes joint efforts by all participants to develop country-by-country action plans to achieve a rational framework of financial reporting. This framework would encompass upgrading not only accounting and auditing standards, but also corporate governance, the accounting and auditing profession, regulation and education. Pilot projects related to the action plans are to be initiated in several countries in 2000. Where any actions are solely or primarily within the control of the major firms, they have agreed to adopt interim measures until long-term solutions can be implemented.

7.42 The Panel applauds IFAD and the major audit firms for this undertaking. IFAD's mission is daunting and will require extraordinary patience, perseverance and statesmanship. The Panel encourages the major audit firms and IFAD's other members to continue their leadership efforts.

STRENGTHENING SYSTEMIC ASSURANCES GLOBALLY

7.43 The Panel is aware of recent proposals to strengthen the influence of IFAC that include a number of ideas for enhancing global self-regulation of the auditing profession. The important goals of this initiative are to involve the large audit firms as catalysts for improving audit quality, further increase the resources available to IAPC and establish the supporting mechanisms for quality review and monitoring.

7.44 The proposals call for IFAC to sponsor a new group of audit firms with transnational clients to work closely with IFAC in developing and encouraging implementation of international accounting and auditing standards. Membership in this IFAC-sponsored group of firms would require, among other things, intra-firm practice reviews and periodic peer reviews. The proposals also include creating an oversight body to oversee all of IFAC's audit-related activities, embracing not only auditing standards, quality review and monitoring, but also ethics (including independence) and education.

7.45 At the time of this report, the Panel has not seen the final proposals that are under

consideration by IFAC. However, given its extensive deliberations on the self-regulatory aspects of the auditing profession in the United States, the Panel believes that its views concerning the global aspects of self-regulation of the auditing profession may be useful to IFAC and other constituencies with an interest in auditing globally. In making its recommendations to IFAC, the Panel is cognizant of the difficulties involved in timely implementation, but believes those difficulties can be overcome if a commitment to do so is made by key interested parties, including audit firms, IFAC, standard setters, preparers of financial statements and regulators.

RECOMMENDATIONS

To the International Federation of Accountants:

7.46 The Panel recommends to IFAC that the global self-regulatory structure of the international auditing profession meet the following criteria:

Public Interest Oversight

- The global self-regulatory structure should have as its centerpiece a global oversight body to monitor and report on the activities of individual country self-regulatory organizations (or the member organizations of IFAC that expressly serve that purpose). The charter of this oversight body should establish clearly that its primary goal is to serve the public interest.²⁰ Membership in this body should be established through a mechanism that ensures its independence and viability. (The Panel's recommendations to the U.S. Public Oversight Board [POB], included in Chapter 6, may be helpful to IFAC in this regard, recognizing that a global structure would not operate in exactly the same manner as the POB.)

The global oversight body should ensure that IFAC imposes on its member organizations clear and unequivocal minimum guidelines for the self-regulation of the auditing profession in each country subscribing to its oversight. Timetables for achieving goals should be established on a by-country basis.

International Auditing Practices Committee

- The global oversight body should be consulted on the membership appointments and agenda of IAPC and evaluate the efficacy of the ISAs and the progress made in achieving their global acceptance. It should ensure that IAPC's standards are comprehensive and sufficiently specific and rigorous so that they serve as appropriate benchmarks to judge the work of auditors. (See "Establishing Auditing Standards" in Chapter 2 for the Panel's recommendations to the ASB.)

²⁰ The public interest, in the context of a global oversight function, includes that of cross-border investors and creditors who obtain assurance from the work of auditors on financial and other information that they use in making investment decisions. It also may include the interests of all users of accounting and auditing services.

- IAPC’s deliberations should be open to the public and the basis for and outcome of its actions published.²¹ Dissenting views of its members should be published to promote the goal of transparency, encourage development of the highest-quality standards and assist in their proper interpretation.

Quality Assurance over Auditing

- A key element of quality assurance by individual self-regulatory organizations should be external reviews of the quality controls of audit firms over their accounting and auditing practices. Minimum global standards for quality control over the audit function should serve as the benchmark for these reviews. (See “Recent Changes to SECPS Membership Requirements” above.) IAPC (or an equivalent technical body) should establish these quality controls standards with due process. The global oversight body should evaluate these standards and the progress of the individual self-regulatory organizations in promoting external reviews and reporting on their results.²² (See the Panel’s recommendation to the SEC in the section “Enhancing Peer Reviews” in Chapter 6.)

Ethics and Independence

- The oversight body should evaluate the adequacy of IFAC’s ethics standards, including independence standards (for firms and individual auditors), in serving the interests of public investors, creditors and other users of financial statements.

Education

- The oversight body should assess IFAC’s process for evaluating the education and training of auditors on a by-country basis and its initiatives for establishing high-level, minimum educational standards for the auditing profession. This process should include monitoring the progress of the profession in each country toward achieving established goals.

By-Country Monitoring, Investigations and Discipline

- The global oversight body should establish a framework for monitoring the accountancy profession to guide the individual country self-regulatory organizations (or equivalent bodies, if not formally designated as self-regulatory organizations).²³

Key elements that the global oversight body should ask each country’s self-regulatory

²¹ IAPC’s meetings take place in various locations throughout the world. IOSCO is invited as an observer in these meetings.

²² The Panel is aware that some elements of “external review” already are called for by IFAC’s International Professional Practice Statement No. 1, *Assuring the Quality of Professional Services*. This recommendation speaks to the role of the global oversight body.

²³ IFAC has set up a Compliance Committee with some functions similar to those described as key elements in this recommendation. This recommendation speaks to the role of the global oversight body.

organization to address include: (1) accounting standards adopted and in use and the status of efforts toward convergence with IASC standards, (2) auditing standards adopted and in use and the status of efforts to apply IAPC standards, (3) ethics (including independence) standards adopted and in use and the status of efforts to adopt international standards as a minimum, (4) educational levels and skills and the status of efforts to achieve goals, (5) quality reviews (including peer reviews) and the status of efforts to achieve goals, (6) monitoring of practice quality by investigating allegations of audit deficiencies or failures and the status of efforts to achieve goals, (7) disciplinary activities and the status of efforts to achieve goals, and (8) the regulatory environment over global financing and changes occurring in that environment.

Membership Requirements of IFAC-sponsored Group of Audit Firms²⁴

- Membership requirements of the proposed group of audit firms that will work with IFAC to raise international standards should include periodic reports by those firms to the global oversight body about their structure and operations.²⁵

Monitoring the Global Auditing Profession

- A system for monitoring the global auditing profession should be established by IFAC that provides for reporting to the global oversight body by the individual self-regulatory organizations. This monitoring activity should address the key elements described above for individual countries.

Reporting to the Public

- There should be comprehensive annual reports to the public by the global oversight body on its activities, including the results of its monitoring of the quality assurance functions for the auditing profession on a by-country basis.²⁶ Such reporting should describe the nature of the self-regulatory processes followed in each country and the results of reporting by each country's individual self-regulatory organization. These reports should address the progress being made by each country toward achieving goals in the areas of standards, quality assurance, ethics and independence, education, monitoring and investigations, and discipline. The global oversight body's goal should be to bring "transparency" to how the global auditing profession functions and

²⁴ The proposed group of audit firms currently is referred to as "The Forum of Firms."

²⁵ For example, World Bank officials have suggested disclosure statements by the various institutions involved in capital flows, including countries, international standard setters and international accounting firms. One official of the World Bank has described possible elements of disclosures for firms as, among other things, the international structure of the firm; what the global use of the firm's name means to clients and others, when associated with financial statements; minimum standards followed; their financial strength; their risk profile; their effective control; and their independence rules (Muis; see note 18).

²⁶ If some or all of these processes are delegated to regional organizations, the results nonetheless should be reported on a by-country basis.

serves the interests of investors.²⁷

To audit firms:

7.47 While the changes in the SECPS membership rules described earlier in this chapter are important first steps, the Panel believes that additional steps are necessary to effect significant improvements in worldwide accounting and auditing quality. The Panel believes that the major firms share this view and that they are in varying stages of upgrading their international quality for the benefit of all users of audited financial statements, not just those who invest in companies whose securities are registered with the SEC.²⁸ Accordingly, the Panel recommends that audit firms²⁹:

- Implement uniform audit methodologies throughout the world that use international auditing standards as the base minimum³⁰
- Subject all audit practice units to periodic inspection procedures covering all audits, not just foreign registrants or affiliates of U.S. SEC registrants
- Assign personnel throughout the world to function as technical consultants in the application of international accounting and auditing standards. Firms should consider establishing intra-firm international “clearinghouses” to resolve differences in the application of international accounting and auditing standards and promote consistency of practice.

To the Auditing Standards Board and the International Auditing Practices Committee:

7.48 The Panel recommends that the ASB and IAPC initiate a formal collaborative effort to harmonize auditing standards and achieve their global acceptance. Others interested in auditing standard setting should be invited to participate in this effort.³¹

7.49 While the Panel encourages this initiative, it also believes that such an effort should be conducted in parallel with the ASB’s consideration of its other recommendations. (See the Panel’s recommendation to the POB and the ASB under “Establishing Auditing Standards” in Chapter 2.)

²⁷ The Panel recognizes that the global oversight body, not IFAC, would determine what to include in its reports. This recommendation gives the Panel’s view of the matters that it considers important and appropriate.

²⁸ Users in this context are those who use financial statements for financing and other needs on a transnational basis.

²⁹ The Panel understands that some audit firms already have made significant progress toward implementing these recommendations.

³⁰ The Panel understands that audits of the financial statements of foreign registrants are required to comply with U.S. GAAS. Nonetheless, it believes that it would be in the best interests of both the public and the audit firms if there were, regardless of jurisdiction, a uniform global “standard” for what constitutes “audit assurance.”

³¹ The Assurance Standards Board of the Canadian Institute of Chartered Accountants and the United Kingdom’s Auditing Practices Board are two auditing standard-setting bodies that addressed the Panel’s Exposure Draft. Two national accountancy organizations, the Institute of Chartered Accountants in England and Wales and the German Institut der Wirtschaftsprüfer, also addressed the Panel’s Exposure Draft. Other standard-setting bodies and IFAC member organizations may be interested in this initiative.