Workshop: Financial Reporting Quality and Its Impact on the Economy – Role of the Public Oversight Board”

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IMPROVING AUDIT QUALITY THROUGH AUDIT OVERSIGHT
Why Public Oversight?

» The modern movement towards public oversight of the auditing profession began with the wave of corporate financial reporting scandals starting about 17 years ago in the U.S., Europe, and Japan.

» Sarbanes-Oxley Act of 2002 followed by the 2006 EU statutory audit directive – a worldwide consensus - auditors cannot adequately regulate themselves, mainly because they do not have sufficient incentive to do so:

- Conflict of Interest
- Corruption
- Market Incentives
Self regulation by the profession and by internal quality procedures – not sufficient any longer

Audit firms themselves attempt to assure consistent quality by developing internal systems of quality control addressing:

- (a) Leadership responsibilities for quality within the firm.
- (b) Relevant ethical requirements.
- (c) Acceptance and continuance of clients and specific engagements.
- (d) Human resources.
- (e) Engagement performance.
- (f) Monitoring.

See ISQC 1

PAOs – in the past mostly focused on areas of access to the profession and less on QA
EU Acquis

Each Member country should have an effective Public Oversight system & Competent Authority

All statutory auditors and audit firms – subject to Public Oversight

The Competent Authority shall have the ultimate responsibility for the oversight of:

(a) the approval and registration of statutory auditors and audit firms;
(b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing, except where those standards are adopted or approved by other authorities;
(c) continuing education;
(d) quality assurance systems;
(e) investigative and administrative disciplinary systems.
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About CFRR of World Bank

Delivered
over 100 events at regional & national levels benefiting over 7000 participants

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- MoF, Poland
- ERFRAG
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Knowledge Activities
Conferences
Workshops
Virtual seminars
Communities of practice
Website and Newsletter

Technical Assistance
In-country support and advice
Just in time support
World Bank Dedicated Projects for Albania

**CFREP - Corporate Financial Reporting Enhancement Project**

» EUR 1.23 mln – Swiss SECO Funding

» Recipient Executed (under leadership of MoFE)

» Launched in April, 2011, closed in 2014.

**Components:**

1. Improving the legal framework in the area of CFR *(Support for Audit Law amendments)*
2. Strengthening the Capacity of the NAC
3. **Improvement of the Audit Oversight System**
4. Improving accounting and auditing curricula for university education and professional certification
5. Project management, strengthening reform capacity, and M&E

**Enhancing the Quality of FINancial REPorting Project**

» EUR 2.2 mln – Swiss SECO Funding

» Recipient Executed (under leadership of MoFE), with a small WB executed part.

» Launched in October, 2016, closing in Dec 2019.

**Components:**

1. Accountancy education
2. **Monitoring and enforcement of financial reporting and auditing** *(support to POB and Financial regulators)*
3. Filing and publication of statutory financial statements
4. Project management, coordination, evaluation and public awareness
Audit Oversight to Improve Financial Reporting

An effective system of public oversight may:

> Improve the overall system of financial reporting by sharpening the quality and rigor of audits and removing the worst performers from the market;

> Enhance public trust in financial reporting and auditing through its work and public profile; and

> Help promote public understanding of auditing and financial reporting through public outreach

Effective independent oversight of auditors adds **credibility** and **value** to financial information. In a competitive environment, market use and demand for financial information should then grow.
Audit Oversight to Improve Functioning of Audit Market

Public oversight can bolster the functioning of the audit market by:

- Enhancing knowledge in the market about the audit function and determinants of audit quality
- Providing more information to the market about the audit quality of particular firms and auditors
- Strengthening incentives, through reporting and enforcement, for firms to improve audit quality
- Removing the worst performers from the market
- Pushing for continuous improvements in practice
The Peculiar Nature of Audit Regulation

» Auditing complex companies does not involve just following some standard set of procedures and ticking boxes on a checklist

» To be effective, an auditor must use knowledge and experience to
  • Understand the company’s business and the way it estimates, records, accumulates, and reports information about its transactions, obligations, and assets
  • Identify the specific risks that might cause some of these items to be reported inaccurately for that company, based on how it operates
  • Use professional judgement to design and perform tests for the particular company to obtain reasonable assurance that the financial reporting is reliable
  • And the auditor must do all of this efficiently, within a reasonable time and at a reasonable cost

» Thus, audit regulators must understand that they are not regulating a routinized activity, in which they could expect to see the same steps and procedures performed every time. This is an enormous challenge for effective regulation.
Strategic Direction of Public Oversight

- Identifying and rooting out the worst auditors, who undermine the audit market, the profession, and the public’s trust
- Using inspections and enforcement as capacity-building tools
- Strengthening the market for audit services to focus more on audit quality and gradually realigning the incentives of the auditing profession
- Serving as a “thought leader” in the development and use of auditing services
Need to Insulate from Excessive Political Influence

Housing the public oversight body as an office within the Ministry of Finance or an equivalent may leave it more vulnerable to political influences, instability, and neglect, particularly in an environment where government ministers are frequently reshuffled.

The selection of board members for the oversight body should be structured to favor relevant experience and competence over political connections.

Terms of board members should be long enough to allow them to take a more-long term view and to give some continuity to the board and its activities.

Ideally, funding should be insulated from big swings in state budgetary priorities & free from undue influence from the profession.