

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

Andrei Busuioc, Senior Financial Management Specialist, CFRR, The World Bank

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IMPROVING AUDIT QUALITY THROUGH AUDIT OVERSIGHT



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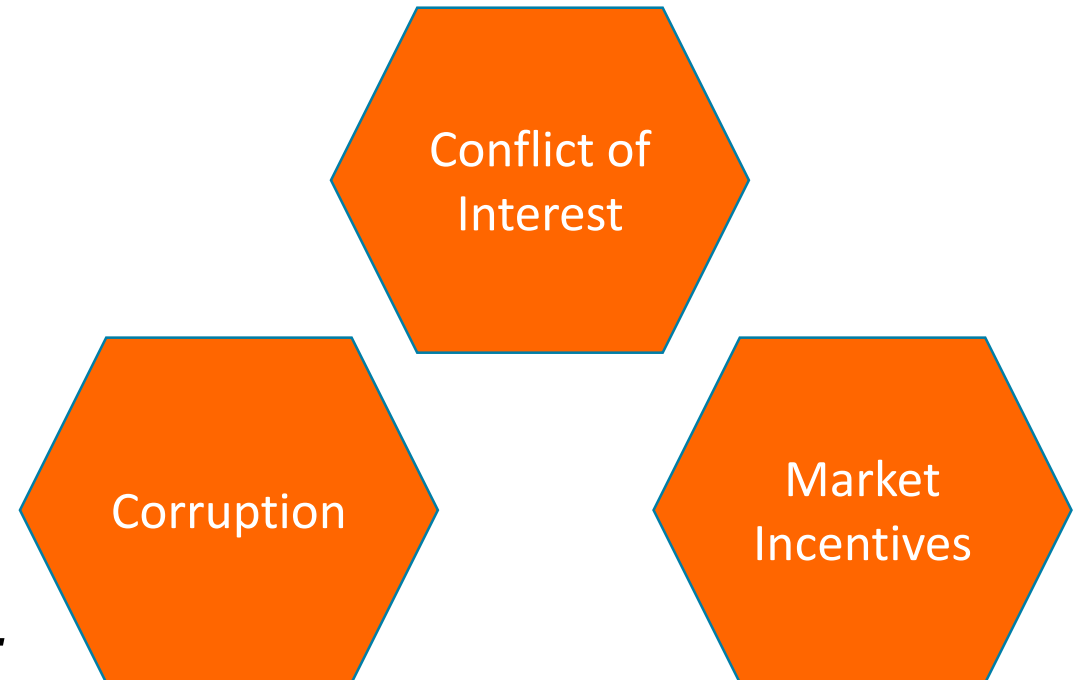
State Secretariat for Economic Affairs SECO

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:





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

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.



EU Acquis

OVERSIGHT OF	non PIEs	PIEs
Approval and registration of statutory auditors and audit firms	may be delegated	may be delegated
Adoption of relevant standards	may be delegated	may be delegated
Continuing education	may be delegated	may be delegated
Quality assurance system	may be delegated	may NOT be delegated
Investigative and administrative disciplinary system	may be delegated	may NOT be delegated

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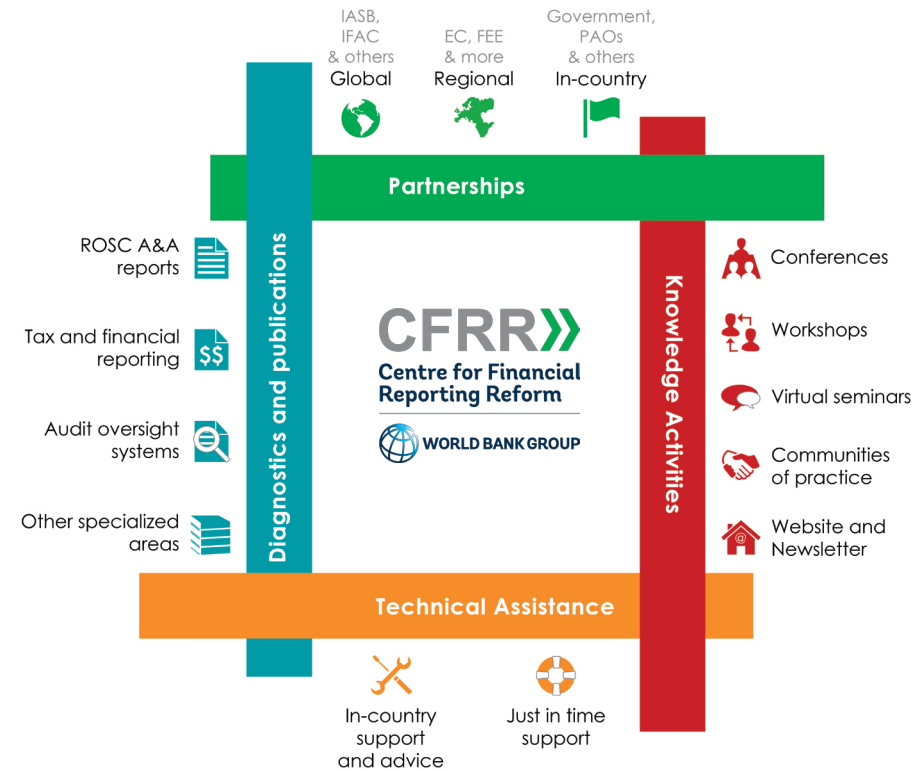
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World Bank Dedicated Projects for Albania

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