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2014 Review

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INTERNATIONAL ACCOUNTING AND REPORTING ISSUES 2014 REVIEW

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PREFACE

The international community has ushered in the Sustainable Development Goals that will guide our collective economic and social development efforts for the coming decade and a half. The importance of the private sector in playing a positive role in attaining the Sustainable Development Goals cannot be overemphasized. For over three decades, the United Nations has been contributing to the global agenda of promoting reliable and comparable corporate reporting through the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR). UNCTAD has enjoyed the unique privilege of hosting ISAR for many years. Member States count on ISAR to continue to develop practical guidance for policymakers and enterprises, including on sustainability-related corporate reporting, with a view to galvanizing the contributions of the private sector to realizing the Sustainable Development Goals.

In addition to high-quality corporate reporting standards that address financial and non-financial aspects of corporate reporting, robust compliance monitoring and enforcement, as well as regulation of the accountancy profession, are essential. Developing countries and countries with economies in transition have been facing significant challenges in establishing such monitoring and enforcement regimes. UNCTAD-ISAR has recently launched the Accounting Development Tool (ADT) to assist member States in addressing, inter alia, these challenges in a comprehensive and integrated manner.

It is my pleasure to present this volume, which contains a review of the essential elements that member States need to have in place to ensure the effective monitoring of compliance with applicable corporate reporting standards and codes, as well as a series of country case studies that elaborate on these elements in a concrete and practical manner.

Mukhisa Kituyi
Secretary-General of UNCTAD

INTRODUCTION

This volume of the International Accounting and Reporting Issues series is focused on the interrelated topics of compliance monitoring and enforcement mechanisms in relation to corporate reporting, auditing and the regulation of professional accountants in the context of achieving high-quality corporate reporting. Over the last two decades, a variety of international standards and codes have been promulgated at the global level and member States have been exerting extensive efforts to consistently implement and enforce these standards and codes. It is important to note, however, that although these standards and codes are articulated at the global level, their implementation and enforcement and related compliance monitoring remain under the purview of national authorities.

Over the past five years, UNCTAD-ISAR has been working to assist member States in achieving high-quality corporate reporting. To this end, ISAR conducted extensive deliberations at its annual sessions and at round tables held in different regions of the world. ISAR enhanced its work on this topic by publishing the Accounting Development Tool, which is intended to assist member States in developing a comprehensive and integrated approach to policy formulation and capacity-building in accounting and reporting. The Accounting Development Tool is founded on four pillars, as follows: legal and regulatory; institutional; human capacity; and capacity-building process. It recognizes the importance of the effective monitoring of compliance and enforcement (MCE) of corporate reporting standards and codes and this is reflected in its different pillars and indicators.

The first chapter of this volume describes the key elements that member States need to consider when building efficient MCE systems for companies, audit firms and professional accountants. It highlights standards and guidance issued by international and regional bodies and selected national good practices and discusses the main challenges faced by countries in their efforts to establish efficient mechanisms for MCE.

In order to facilitate the sharing of experiences among member States and to provide practical examples of MCE mechanisms in relation to international corporate reporting standards and codes, the UNCTAD secretariat, in cooperation with leading experts on these topics, prepares country case studies. In this volume, country case studies for Australia, Belgium and Canada are provided in chapters II through IV, respectively. Each case study provides an overview of the general economic setting and corporate reporting environment of the respective country. The case studies elaborate extensively on MCE of the corporate reporting framework, audit and assurance standards and codes of professional conduct and other applicable professional membership requirements. Although the case studies focus on mature markets, they also address issues that are highly relevant for developing countries aiming to introduce good practices. Additional country case studies will be published in subsequent volumes in the International Accounting and Reporting Issues series.

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CONTENTS

ACRONYMS

AASB	Australian Accounting Standards Board
AcSB	Accounting Standards Board (Canada)
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
CAANZ	Chartered Accountants Australia and New Zealand
CLERP 9	Corporate Law Economic Reform Programme (Audit Reform and Corporate Disclosure) Act, 2004
CPA	chartered professional accountants
CPAB	Canadian Public Accountability Board
ESMA	European Securities and Markets Authority
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GDP	gross domestic product
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPA	Institute of Public Accountants
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
MCE	monitoring of compliance and enforcement
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission

CHAPTER I. KEY FOUNDATIONS FOR HIGH-QUALITY CORPORATE REPORTING: GOOD PRACTICES OF MONITORING AND ENFORCEMENT, AND COMPLIANCE MECHANISMS

A. INTRODUCTION AND BACKGROUND

The UNCTAD-ISAR Accounting Development Tool consists of an accounting development framework and a set of accounting development indicators.[1] Its objective is to assist policymakers and other stakeholders in their efforts to strengthen their accounting and reporting infrastructures, to achieve high-quality and internationally comparable corporate reporting. Appendix I.1 provides a graph of the Accounting Development Tool scores of three sample countries, for illustrative purposes.

A series of international benchmarks related to corporate reporting has emerged over the last two decades. The benefits of high-quality standards cannot be attained, however, unless they are properly implemented. Countries need to apply a comprehensive approach to ensure the establishment of an efficient system of mechanisms for MCE and their proper implementation by companies and audit firms. It is also important to ensure the implementation and enforcement of requirements for professional accountants, defined by the UNCTAD-ISAR guidelines on national requirements for the qualification of professional accountants as persons who are qualified to be, or who are, members of a recognized professional body of accountants or auditors, or who are recognized as such by a regulatory body.

Different studies have shown evidence of the positive impact of enforcement on corporate transparency and the quality of reporting. For example, Christensen et al. (2011) found that the capital market effects of two directives issued in the European Union to reduce market abuse and improve transparency regulation and enforcement were stronger in countries with stricter securities regulation, better public enforcement regimes and a history of higher regulatory quality.[2] Christensen et al. (2013) reported that the benefits of International Financial Reporting Standards (IFRS) were seen in countries that increased their accounting enforcement activity at the time of the adoption of IFRS in 2005.[3] Brown et al. (2014) found that audit and accounting enforcement was crucial to the application of IFRS and that the effectiveness of adoption of IFRS might be hampered by differences in institutional settings across countries.[4]

At regional levels and the international level, there are key organizations in charge of strengthening practices of regulation, supervision and monitoring in the different economic sectors, including major bodies such as the Basel Committee, which is the global standard setter for the prudential regulation of banks, European Commission, European Group of Auditors' Oversight Bodies, European Securities and Markets Authority (ESMA; formerly the Committee of European Securities Regulators), Financial Stability Board, International Federation of Accountants (IFAC), International Forum of Independent Audit Regulators and International Organization of Securities Commissions (IOSCO).

In recent years, a number of pronouncements, standards and guidelines have been issued with regard to MCE at the international level and at regional levels, including the following: guidance on the cooperation between responsible authorities in the European Union, by the European Group of Auditors' Oversight Bodies; policy position on the regulation of the accountancy

[1] UNCTAD, 2010, Capacity-building framework for high-quality corporate reporting, TD/B/C.II/ISAR/56, 20 August.

[2] HB Christensen, L Hail and C Leuz, 2011, Capital-market effects of securities regulation: Hysteresis, implementation and enforcement, National Bureau of Economic Research Working Paper 16737, available at http://www.nber.org/papers/w16737.pdf (accessed 30 July 2014).

[3] HB Christensen, L Hail and C Leuz, 2013, Mandatory IFRS reporting and changes in enforcement, *Journal of Accounting and Economics*, 56:147–177.

[4] P Brown, J Preiato and A Tarca, 2014, Measuring country differences in enforcement of accounting standards: An audit and enforcement proxy, *Journal of Business Finance and Accounting*, 41(1-2):1–52, available at http://onlinelibrary.wiley.com/doi/10.1111/jbfa.12066/pdf (accessed 30 July 2014).

profession, by IFAC; core principles for independent audit regulators, by the International Forum of Independent Audit Regulators; and objectives and principles of securities regulation, by IOSCO. Two standards on the enforcement of financial information and coordination were developed by the Committee of European Securities Regulators and issued in April 2003 and April 2004.[5] Guidelines on the enforcement of financial information were published by ESMA in July 2013 as a consultation paper and in July 2014 as a final report, and replaced these two standards.[6]

Building a sound MCE system remains a challenge in many countries, particularly developing countries and countries with economies in transition, due to the complexity of such a system, its relative novelty and its significant interdependence with the different institutional and legal settings of national jurisdictions, as well as the required resources and the lack of awareness of good practices and of studies and guidance on the implementation of international requirements in this area. Existing national regulatory bodies frequently lack the mandates, resources and methodologies required to monitor and enforce accounting and auditing requirements.

The findings of Accounting Development Tool pilot tests carried out in 2012 and 2013, and subsequent discussions of these findings at ISAR sessions, reflected that countries require further guidance on building efficient mechanisms for MCE. In some cases, MCE systems are non-existent or ineffective. Many developing countries also lack a qualification process for professional accountants and licensing mechanisms for audit professionals[7] and face many other MCE-related challenges in building a solid infrastructure for high-quality reporting. In response to these challenges, ISAR at its thirtieth session proposed to focus its deliberations during the thirty-first session on mechanisms for MCE.

This chapter was prepared by UNCTAD to facilitate discussions on this topic. It details the main components required for a strong MCE system for high-quality corporate reporting, highlights standards and guidance issued by international and regional bodies and provides illustrative examples of selected national requirements and practices. This chapter also addresses MCE-specific issues with regard to the implementation of accounting and audit standards and discusses MCE mechanisms for requirements for professional accountants. Finally, the main cross-cutting challenges faced by countries in their efforts to establish efficient mechanisms for MCE are outlined. Important evolving areas such as MCE of non-financial requirements and public sector reporting are not included as further research is required.

B. DEFINITIONS AND MAIN ELEMENTS OF THE MONITORING OF COMPLIANCE AND ENFORCEMENT

A sound national MCE system requires a clear understanding of the concept, objective and scope, taking into account interrelations with other aspects of the legal and institutional systems of the country. Such a system also requires the following: designing a set of MCE-related activities and methodologies for both the prevention and correction phases; allocating appropriate human, financial and technological resources; and establishing an adequate organizational structure that promotes a fair, transparent and efficient process, including coordination mechanisms with other areas of legislation and regulation and other authoritative bodies at national and international levels, as well as at the regional level if regional enforcement mechanisms exist, as for example in the European Union.

Compliance is understood as adherence to laws, regulations and rules. Monitoring and supervision seek to discourage non-compliance, while enforcement is a disciplinary function that seeks to ensure that there are consequences to the violation

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5 Committee of European Securities Regulators, 2003, Standard no. 1: Enforcement of standards on financial information in Europe, available at http://www.esma.europa.eu/system/files/03_073.pdf (accessed 30 July 2014); Committee of European Securities Regulators, 2004, Standard no. 2: Coordination of enforcement activities, available at http://www.esma.europa.eu/system/files/03_317c.pdf (accessed 30 July 2014).

6 ESMA, 2013, Guidelines on enforcement of financial information, available at http://www.esma.europa.eu/press-news/consultations/guidelines-enforcement-financial-information (accessed 4 January 2016).

7 The International Auditing and Assurance Standards Board defines an audit professional as a professional accountant who has responsibility, or has been delegated responsibility, for significant judgements in an audit of historical financial information.

of rules, involving a set of tools used to punish breaches of laws and regulations and to deter future violations. However, enforcement may also be understood in a broader manner through the inclusion of compliance as part of the enforcement system. In each instance it is critical, while designing and implementing an MCE system, to consider the interdependence of the legal framework, supervision and enforcement.[8]

IOSCO, in its objectives and principles of securities regulation, establishes that enforcement should be interpreted broadly enough to encompass powers of surveillance and inspection, as well as investigation, such that regulators should be expected to have the ability, the means and a variety of measures to detect, deter, enforce, sanction, redress and correct violations of securities laws.[9] The principles do not prescribe any specific model to be followed since their implementation requires a consideration of the legal system in which a regulator operates.

The ESMA guidelines on the enforcement of financial information define such enforcement as examining the compliance of financial information with the relevant reporting framework, taking appropriate measures when infringements are discovered during the enforcement process in accordance with the rules applicable under the transparency directive and taking other measures relevant for the purpose of enforcement. Accounting enforcement has also been defined as the activities undertaken by independent bodies, such as monitoring, reviewing, educating and sanctioning, to promote the compliance of firms with accounting standards in their statutory financial statements.[10]

In this volume, the term MCE includes the complete cycle of such monitoring, from the selection of companies, audit firms or professional accountants to be reviewed to the execution of corrective measures and sanctions when required. Monitoring of compliance refers to the supervision and investigation conducted to verify compliance, and enforcement refers to the action of obliging adherence to the respective requirements and the implementation of sanctions when violations are found.

To ensure an efficient MCE system it is important to define the objective and scope of such a system. For example, the ESMA guidelines state that the objective of enforcement included in harmonized documents is to contribute to a consistent application of the relevant reporting framework and to the transparency of financial information relevant to the decision-making process of investors and other users. Such consistency and transparency are important for financial stability, in avoiding regulatory arbitrage, in increasing supervisory convergence in a region and in fostering investor confidence. In this regard, a clear division of responsibilities between major players in a reporting chain, such as enforcers, preparers and auditors, is critical. For example, one of the issues raised in the consultation process preceding the finalization of the ESMA guidelines was the importance of ensuring that an enforcer does not assume some standard setter and audit functions while avoiding issuing interpretations of accounting standards.

Several other issues may arise in defining the scope of an MCE system, including who to subject to MCE-related actions and what kind of information should be assessed. Consideration should also be given to which elements in a reporting chain should fall under the scope of an MCE system. For example, some sources consider the following as attributes of institutional functions that promote the quality of financial reporting: rule of law; regulatory quality; control of corruption; government effectiveness; political stability; and voice and accountability.[11] Additional factors include manager incentives, auditor quality and incentives, regulation, enforcement, ownership structure and other institutional features of the economy.[12] The Federation of European Accountants identifies essential characteristics, such as the legal system, corporate governance, statutory audits, institutional oversight system, courts and public

[8] A Carvajal and J Elliott, 2009, The challenge of enforcement in securities markets: Mission impossible?, International Monetary Fund Working Paper 09/168, available at http://www.imf.org/external/pubs/ft/wp/2009/wp09168.pdf (accessed 30 July 2014).

[9] IOSCO, 2013, Methodology for assessing implementation of IOSCO objectives and principles of securities regulation, Report no. FR08/11, available at http://www.csrc.gov.cn/pub/newsite/gjb/gjzjhzz/ioscojgmbyyz/201004/P020150520677186250144.pdf (accessed 4 January 2016).

[10] P Brown, J Preiato and A Tarca, 2014.

[11] Ibid.

[12] RW Holthausen, 2009, Accounting standards, financial reporting outcomes and enforcement, *Journal of Accounting Research*, 47:447–458.

and press sanctions.[13] (Compliance with reporting standards depends on various factors, including internal controls and risk management. However, the particularities of this topic are beyond the scope of this volume.)

An MCE system should have a solid institutional basis and be carried out by competent administrative authorities, with clear responsibilities and comprehensive investigation and enforcement powers. IOSCO emphasizes in its methodology for assessing the implementation of its objectives and principles of securities regulation that in an effective and credible enforcement system, the regulator should be able to perform the following activities:

(a) Detect suspected breaches of law in an effective and timely manner

(b) Gather the relevant information for its investigation

(c) Take action when a breach is identified

(d) Demonstrate that it has programmes in place and utilizes its resources to effectively exercise its activities

(e) Require a compliance system to be in place for regulated entities, which includes inspections and is aimed at preventing, detecting and correcting any violations

IOSCO also states that it is not necessary that responsibility for all aspects of enforcement of securities regulations be given to a single body. There are several effective models, including models in which responsibilities are shared with self-regulatory organizations, defined as organizations that exercise some direct oversight responsibility for their respective areas of competence.

An MCE system also includes a number of activities and methodologies, such as selection methods and examination procedures, which are addressed in more detail in section C of this chapter. In addition, an MCE system should include a set of enforcement actions such as corrective measures, incentives and sanctions. For example, with regard to securities regulations, IOSCO states that regulators must demonstrate that there are a variety of sanctions available, which are proportionate, dissuasive, effective and sufficient to cover the spectrum of securities violations, examples of which include the following: fines; disqualification; suspension and revocation of authority to do business; asset freezes; action against unlicensed persons in conducting securities transactions or referral of such activities to criminal authorities; and measures to enforce disclosure and financial reporting requirements for issuers.

To achieve an efficient MCE system, it is important to develop a set of indicators to assess the impact of implemented actions and to identify gaps and priorities for further improvement. Examples of metrics include the following: resources dedicated to an enforcement programme; level of fines imposed per year; number of cases filed per year; and number and types of investigations conducted per year. Several studies have been conducted to assess the efficiency of national MCE systems.[14]

The Accounting Development Tool includes several quantitative indicators that are directly related to the level of development of the MCE system in a given country.[15] The indicators contain questions and checklists to ensure that key elements are present in a country's MCE system for high-quality corporate reporting, including the following: existence of MCE-related functions; independent, adequately funded and well-staffed institutions; selection criteria for inspections; methods for reporting findings; imposition of public sanctions; licence requirements for auditors; codes of ethics and committees of investigation, discipline and appeals for professional accountants; and coordination mechanisms for national institutions.[16]

Many factors and issues thus affect the quality of corporate reporting. However, such aspects as adherence to a statutory reporting framework and audit and professional requirements for accountants and auditors most directly impact the quality of reporting. Specific issues regarding MCE in these areas are discussed in more detail in section C of this chapter.

13 Federation of European Accountants, 2001, Enforcement mechanisms in Europe: A preliminary investigation of oversight systems, available at http://www.iasplus.com/en/binary/resource/fee0104.pdf (accessed 30 July 2014).

14 Ibid. and P Brown, J Preiato and A Tarca, 2014.

15 UNCTAD, 2013, Accounting Development Tool: Assessment questionnaire on a country's capacity for high-quality corporate reporting, available at http://adt.unctad.org/wp-content/uploads/2014/01/ADT-18-March2013-final.pdf (accessed 30 July 2014).

16 UNCTAD, 2015, *Accounting Development Tool: Building accounting for development* (New York and Geneva, United Nations publication).

C. MONITORING OF COMPLIANCE AND ENFORCEMENT OF CORPORATE REPORTING REQUIREMENTS, AUDITING REQUIREMENTS AND QUALITY ASSURANCE AND REQUIREMENTS FOR PROFESSIONAL ACCOUNTANTS

1. Monitoring of compliance and enforcement of accounting and corporate reporting requirements

As noted, accounting enforcement refers to the functions performed by independent regulators to ensure the compliance of a company's financial information with accounting standards and the relevant reporting framework required by a country.

Mechanisms for MCE in most countries are focused on listed companies and public interest entities due to their roles in the economy. However, some enforcers, such as in Denmark, Switzerland and the United Kingdom of Great Britain and Northern Ireland, are also responsible for certain non-listed companies.[17] The enforcer – the competent authority conducting enforcement activities – varies depending on the institutional arrangements in a country. The majority of countries have one institution in charge of conducting such activities, or one-tier system. In many countries, the securities and exchange commission or the superintendencies of companies, banking and/or the insurance sector represent the authority in charge of conducting such activities. Other countries, such as Austria and Germany, have a two-tier system in which two separate institutions participate in the related activities at different stages. The two-tier system in Germany is described in box 1.

As noted, an essential element of an enforcement system is the methodology for selecting the companies to be reviewed. For example, according to the ESMA guidelines, enforcers select companies to inspect based on a combination of a risk-based approach and either random sampling or rotation or both. Risk determination is based on a combination of the probability of infringements and the possible impact of a potentially significant infringement on financial markets. Characteristics such as the complexity of financial statements, risk profile of the issuer and experience of management and auditors are also considered. Other aspects that may be considered in developing selection criteria include risks related to a specific sector, the relevance of the financial information to other issuers, common findings from previous examinations, complaints received, referrals by other regulatory bodies and issues raised in the press.

[17] A Berger, 2010, The development and status of enforcement in the European Union, Accounting in Europe, 7:15–35.

[18] Financial Reporting Enforcement Panel, 2014, Examination process, available at http://www.frep.info/pruefverfahren/ablauf_eines_pruefverfahrens_en.php (accessed 30 July 2014).

[19] Federal Financial Supervisory Authority, 2014, Financial reporting enforcement, available at http://www.bafin.de/EN/Supervision/StockExchangesMarkets/FinancialReportingEnforcement/financialreportingenforcement_node.html (accessed 4 January 2016).

Box 1. Two-tier enforcement system for companies in Germany

Procedures at the first level are conducted by the Financial Reporting Enforcement Panel.[18] An examination of individual and consolidated annual financial statements is initiated if there are concrete indications of an infringement, if a request is received from the Federal Financial Supervisory Authority[19] or based on random sampling. The Authority publishes a list of the companies subject to enforcement.

If a company does not cooperate with the examination or does not agree with the findings or there are substantial doubts as to whether the examination was properly conducted, the Authority enters at the second level and can take supervisory measures.

Whenever erroneous accounting is established by the Panel or the Authority, the latter requires firms to disclose these findings in a dedicated press release, aired via the electronic platform of the federal registry and, in addition, published in at least three daily financial newspapers or through an electronic information provider. The Authority requires firms to refrain from making comments or additions. The publication of an error finding mechanically triggers an investigation of the auditor by the auditing oversight authorities.

Another important decision to be made is the nature of the examination procedure to be chosen. For example, guideline six of the ESMA states that enforcers may either use unlimited scope examination or a combination of unlimited scope and focused examinations of the financial information of issuers selected for enforcement. According to the ESMA guidelines, an unlimited scope examination of financial information (previously called a full review) is the evaluation of the entire content of financial information to identify issues or areas that need further analysis and to assess whether the financial information complies with the relevant financial reporting framework. A focused examination (previously called a partial review) is the evaluation of pre-defined issues in financial information and the assessment of whether the financial information is compliant with the relevant financial reporting framework with respect to those issues. The sole use of focused examination is not considered satisfactory. The guidelines provide examples of examination procedures, including the following:

(a) Reviewing annual and interim consolidated financial reports

(b) Asking questions of the issuer concerning areas with significant risks and accounting issues

(c) Asking questions of auditors

(d) Referring matters to the bodies responsible for the audit and/or approval of financial information

(e) Identifying sectorial accounting issues

(f) Engaging external experts

(g) Engaging in on-site inspections

The ESMA guidelines recommend documenting the examination techniques used and the conclusions of a review. After a review, identified potential infringements are discussed with the issuer. If the accounting treatment is not acceptable and a material misstatement[20] is detected, there are a range of actions available, depending on the jurisdiction, including requiring the issuance of revised financial statements or public corrective notes or other public announcements and the addition of corrections to future financial statements. If the departure from the financial reporting framework is immaterial, the enforcer sends a notification to the issuer and, usually, this is not made public. There are also different requirements with regard to the frequency of reviews. Berger (2010) noted the frequency of examination in some European countries as follows:

(a) Denmark – 20 per cent of the companies each year. Due to use of a risk-based approach, companies may be selected several times within a five-year period

(b) France – the 140 largest companies every three years and the rest every five years

(c) Netherlands – in addition to risk-based selection, the goal is to examine each equity issuer every five years and each debt issuer every seven years

(d) Spain – Equity issuers examined approximately every two years and debt issuers approximately every six years

(e) Switzerland – in addition to risk-based selection, the goal is to examine each company every six years

The Financial Reporting Enforcement Panel in Germany requires an examination every four to five years of all companies included in a stock index and every 8 to 10 years of all other companies. In 2013, the Panel completed 110 examinations.[21] Hitz et al. (2012), in a study on the enforcement of accounting standards in Germany, highlighted that risk-based selections made up 15 to 20 per cent of investigations and random sampling accounted for 80 to 85 per cent.[22]

2. Monitoring of compliance and enforcement of auditing requirements and quality assurance

With regard to audit activities, there is a global trend to use the term oversight to refer to the MCE-related activities of auditors and audit firms, particularly with respect to listed companies and public interest entities.

[20] Materiality should be assessed according to the relevant reporting framework used for the preparation of the financial information.

[21] Financial Reporting Enforcement Panel, 2014, Annual activity report 2013, available at http://www.frep.info/docs/jahresberichte/2013/2013_tb_en.pdf (accessed 30 July 2014).

[22] J-M Hitz, J Ernstberger and M Stich, 2012, Enforcement of accounting standards in Europe: Capital market-based evidence for the two-tier mechanism in Germany, *European Accounting Review*, 21:253–281.

Many audit oversight bodies have emerged in the last decade, especially in developed countries. Albrecht et al. (2012) noted that mature economies that had established an audit profession oversight body had an advanced auditing profession and a well-developed business regulatory environment.[23] Their study suggested a significant positive relationship between the use of oversight bodies and licensing requirements and a lower perception of corruption.

The scope of audit oversight varies across jurisdictions. In many countries oversight is mainly directed to audit firms in charge of reviewing listed companies, while other countries broaden the focus to include public interest entities. There are also variances with regard to whether oversight is conducted only of audit firms or also includes auditors. On the one hand, including individuals adds costs and complexity to the system, while on the other hand there is the advantage of having the direct ability to sanction individuals and prevent those that have been sanctioned while at one audit firm to move to another and continue to undertake audits.

At the international level, the International Forum of Independent Audit Regulators has established a set of core principles for independent audit regulators related to oversight of audit firms and auditors of public interest entities, including listed companies.[24] The principles state that a system of audit oversight can only be effective when certain preconditions exist, including high-quality accounting and auditing standards, legal requirements for the preparation and publication of financial statements, an enforcement system for preparers of financial statements, corporate governance arrangements and effective educational and training arrangements for accountants and auditors.

Effective oversight of those performing audit services is critical to the reliability and integrity of the financial reporting process. A sound oversight system of public companies generally includes the following:

(a) Requiring auditors to have adequate qualifications and professional competency before being licensed to perform audits

(b) Withdrawing authorization to perform audits if the requirement in (a) is not maintained

(c) Requiring auditor independence

(d) Having an independent oversight body for auditors or a professional body acting as the oversight body but overseen by a higher authority

Independent audit regulators are normally in charge of the following:

(a) Conducting regular reviews of audit procedures and practices of firms that audit public issuers

(b) Addressing other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients and consulting and other non-audit services

(c) Disciplinary activities

Oversight bodies vary across countries. In some cases there is a separate panel in charge of such activities while in others regulators conduct such activities themselves, and still others have professional accountancy organizations regulating audits for some public interest entities or non-public interest entities, with oversight from an independent audit regulator. For example, in the United States, the Sarbanes-Oxley Act that came into force in 2002 initiated a new era of audit activities by ending over a century of self-regulation and establishing independent oversight of public company audits by the Public Company Accounting Oversight Board (PCAOB).[25] The Act introduced several changes concerning audit committees, strengthened auditor independence, required mandatory rotation of the lead engagement partner every five years and established certain types of non-audit services as off-limits to audit firms that provide auditing services to a public company. Further details are provided in box 2. Many other countries have since followed the initiative of the United States and created independent oversight institutions.

Deloitte (2013), which included data from Australia, Canada, Singapore, the United Kingdom, the

[23] C Albrecht, R Malagueno, D Holland and M Sanders, 2012, A cross-country perspective on professional oversight, education standards and countries' perceived level of corruption, *Cross-Cultural Management: An International Journal*, 19:433–454.

[24] Available at http://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 30 July 2014).

[25] Ernst and Young, 2012, The Sarbanes-Oxley Act at 10: Enhancing the reliability of financial reporting and audit quality, available at http://www.ey.com/Publication/vwLUAssets/The_Sarbanes-Oxley_Act_at_10_-_Enhancing_the_reliability_of_financial_reporting_and_audit_quality/$FILE/JJ0003.pdf (accessed 30 July 2014).

Box 2. The United States Public Company Accounting Oversight Board

Auditors of public companies listed in the United States, whether located in the United States or abroad, must be registered with and inspected by PCAOB. In some jurisdictions, PCAOB requires a cooperative agreement to conduct inspections.

The Securities and Exchange Commission (SEC) is responsible for appointing and removing PCAOB members and for approving its annual budget and accounting support fee. Adverse inspection reports of PCAOB, remediation determinations and disciplinary actions against registered firms and their associated persons are subject to review by SEC.

PCAOB establishes auditing and related professional practice standards for registered public accounting firms and before adopting new standards or making amendments to existing standards publishes them for comment. All PCAOB standards must be approved by SEC before they become effective.

Registered firms that issue audit reports for more than 100 public companies and other issuers are required to be inspected annually. Registered firms that issue audit reports for 100 or fewer issuers are inspected at least once every three years. At any time, PCAOB may also inspect any other registered firm. The review of a firm's work typically focuses on engagements and areas of those engagements presenting more significant risks of financial reporting misstatements and related auditing challenges and audit deficiencies.

PCAOB prepares a report of each inspection and makes portions of each report publicly available, subject to statutory restrictions on public disclosure. If an inspection report includes criticisms of or identifies potential defects in a firm's system of quality control, PCAOB is prohibited from publicly disclosing the criticisms if the firm addresses them to the satisfaction of PCAOB within 12 months of the issuance of the report. Otherwise, they are made public.

At the end of 2012, there were 2,363 firms registered with PCAOB, including 1,452 domestic firms and 911 non-United States firms, located in 87 jurisdictions.[26] In 2012, PCAOB had a total of 766 employees.

United States and the European Union, stated that regulatory oversight in these key jurisdictions included registration, inspection, investigation, enforcement, standard setting and continuing professional education activities.[27] In general, the recurring inspections process comprises the following:

(a) Selection of the audit firm to be inspected. Many countries use a risk-based approach to select the firms to be inspected. The review frequency varies, but in the United Kingdom, the four largest audit firms are subject to inspection on an annual basis, while the other major firms that audit public interest entities are reviewed on an extended cycle.

(b) Appointment of an inspection team with appropriate expertise and competence in auditing and financial reporting and training in regulatory quality assurance reviews. Deloitte (2013) noted that in the European Union, the selection of reviewers followed a procedure that ensured that there were no conflicts of interest between reviewers and the statutory auditor or audit firm under review. The scope of a quality assurance review, supported by adequate testing of selected audit files, includes an assessment of compliance with applicable auditing standards and independence requirements, the quantity and quality of resources spent, audit fees charged and the internal quality control system of the audit firm.

(c) Notification to the audit firm, an advance documentation request, notification of the selection of audit engagements for review, meetings with management and on-site inspection arrangements. The inspection process is subject to internal quality control within the audit regulator.

26 PCAOB, 2013, 2012 annual report, available at http://pcaobus.org/About/Ops/Pages/default.aspx (accessed 30 July 2014).

27 Deloitte, 2013, Report on independent audit oversight, available at http://www.frc.org.hk/pdf_20131010/Full%20Report.pdf (accessed 30 July 2014).

Oversight bodies should have timely and effective mechanisms for obtaining and processing relevant information and enforcement powers to ensure that their recommendations or findings are addressed, including the ability to impose a range of sanctions that include fines and the removal of an audit licence and/or registration. The actions of oversight bodies should be subject to scrutiny and review, including appeal to a higher authority.

Principle 11 of the International Forum of Independent Audit Regulators states that the reporting procedures of audit regulators should include a draft inspection report, a process for the audit firm to respond and a final inspection report. In the European Union, a report containing the main conclusions of a quality assurance review is published annually by member States, along with an annual work programme and activity reports. These are of the system as a whole, not necessarily at an individual firm or audit level. Recommendations in quality reviews must be followed up by auditors within a reasonable period; otherwise auditors are subject to disciplinary actions or penalties and sanctions, including fines, suspensions, the withdrawal of licences, certifications or registrations and requirements to undertake training. In the European Union, countries are obliged to make public the disciplinary sanctions imposed on statutory auditors and audit firms. Countries have different resources for appeal; some countries have an appeals committee, while in others an appeal must be addressed to a court.

With regard to the regulation of overseas auditors, different approaches are followed by different regulators. For example, PCAOB applies the same regime to overseas auditors of SEC registrants and domestic registrants. The European Union, on the other hand, has an equivalent audit regime, by which it grants certain countries approval to conduct their own audit oversight functions after having evaluated their enforcement systems.

In Germany, auditors and audit firms who perform statutory audits of public interest entities are subject to inspections by the Auditor Oversight Commission. Commission inspectors must be qualified as auditors and have several years of experience with audits of large corporations whose accounts are prepared in accordance with national and international accounting standards.[28] Audit firms of public interest entities who have undertaken more than 25 relevant audit engagements in the previous year are subject to annual inspections. Firms with fewer relevant audit engagements are reviewed at least every three years. However, audit firms are also selected on a risk basis.

In Singapore, the four largest firms are inspected once every two years.[29] The remaining public interest firms are typically inspected once every three years. Inspections of non-public interest firms are carried out with the assistance of the Institute of Singapore Chartered Accountants, with oversight by the Accounting and Corporate Regulatory Authority. The majority of Singapore's public accountants are in the non-public interest segment and most of them conduct their operations as sole proprietorships and audit mostly small and medium-sized enterprises.

The Canadian Public Accountability Board (CPAB) is responsible for the regulation of accounting firms that audit Canadian public companies. Each year, CPAB inspects all firms that audit more than 100 reporting issuers.[30] The remaining firms are subject to inspection either once every two years or once every three years, depending on the number of their reporting issuer clients.

3. Monitoring of compliance and enforcement of requirements for professional accountants

A series of changes in the regulation of professional accountants has taken place in many countries. Different institutional arrangements currently exist, including self-regulation by the profession through professional accountancy organizations, self-regulation with public oversight from an independent government agency and external regulation, in which the profession is regulated by the Government through a government or independent agency. The latter has become more common in particular for professional auditors. For example, the Accounting and Corporate Regulatory Authority is the national regulator of

28 Auditor Oversight Commission, 2014, Inspections: Competence, inspection teams, available at http://www.apak-aoc.de/english/inspections/inspections.asp (accessed 30 July 2014).

29 Accounting and Corporate Regulatory Authority, 2013, Practice monitoring programme: Seventh public report, available at http://www.acra.gov.sg/Publications/Reports/Practice_Monitoring_Programme_Public_Reports/ (accessed 30 July 2014).

30 CPAB, 2013, Thinking differently about audit quality: 2013 annual report, available at http://www.cpab-ccrc.ca/en/topics/Reports/Pages/default.aspx (accessed 30 July 2014).

business entities and public accountants in Singapore. Its Public Accountants Oversight Committee registers public accountants, determines standards and other professional requirements and manages, among others, a practice monitoring programme and complaint and disciplinary procedures.

In 2011, IFAC issued a position statement related to the accountancy profession, including professional accountants and auditors.[31] IFAC stressed the role of professional accountancy organizations in providing assurance of the quality of services conducted by its membership. Such organizations need to promote high-quality professional practices and oversee the activities of their members even when external regulation of the profession is performed by a government agency.

IFAC also established, in 2012, seven statements of membership obligations that contain a framework for credible and high-quality professional accountancy organizations by supporting the adoption and implementation of international standards and maintaining adequate enforcement mechanisms. IFAC set up a member body compliance programme, which is overseen by the Compliance Advisory Panel. IFAC members and associates provide self-assessment information about the regulatory and standard setting frameworks in their countries and the activities of their organizations in addressing the requirements in the statements. Based on this information, they develop action plans for improvement. For example, the Institute of Certified Public Accountants of China notes in its action plan that in 2009 it established the China Ethics Standards Board for certified public accountants, which approved a new code of ethics in convergence with the code of ethics of the International Ethics Standards Board for Accountants established by IFAC. In order to promote implementation of the ethics code, the action plan notes that the Institute of Certified Public Accountants of China will conduct quality assurance reviews and that the Institute's Professional Standards and Technical Guidance Department will provide guidelines and explanatory materials.

According to IFAC, the areas of the accountancy profession that require regulation are as follows:

(a) Entry requirements and certification, qualification and licensing. International education standards, as detailed in the Handbook of International Education Pronouncements of IFAC, describe the minimum requirements in terms of education and training. Continuing professional development is necessary to ensure that individuals maintain a certain level of quality.

(b) Monitoring of the behaviour and performance of professional accountants. In practice, auditors are the main group subject to scrutiny and constant monitoring by a government or oversight body. If there is a complaint concerning the behaviour of a professional accountant, professional accountancy organizations rely on their investigation and discipline committees. The International Ethics Standards Board for Accountants issues internationally recognized ethics standards for professional accountants, including auditor independence requirements. For example, the Institute of Chartered Accountants of South Africa has an ethics committee in charge of conducting an ongoing review of the code of professional conduct to ensure its relevance to current practice and of considering matters related to professional conduct or ethics referred to it.

(c) Discipline and sanction mechanisms, for performing investigations and imposing sanctions depending on the gravity of an offence, including the power to withdraw certifications or licences in the event of misconduct. In many countries, the lack of legal support for professional accountancy organizations does not allow them to impose such sanctions. For example, the Association of Accountants in Chile cannot impose its standards or oblige all professionals to follow them, including the code of ethics and sanctions system.[32] IFAC conducts a series of activities to strengthen professional accountancy organizations through its Professional Accountancy Organization Development Committee. In 2013, IFAC published a report highlighting discipline,

[31] IFAC, 2011, Regulation of the accountancy profession, Policy position paper no. 1, available at http://www.ifac.org/publications-resources/regulation-accountancy-profession-1 (accessed 30 July 2014).

[32] UNCTAD, 2013, *International Accounting and Reporting Issues: 2013 Review* (New York and Geneva, Sales no. E.14.II.D.3, United Nations publication), available at http://unctad.org/en/PublicationsLibrary/diaeed2013d4_en.pdf (accessed 4 January 2016).

investigation and quality assurance as areas that require further development, especially in developing countries.[33]

(d) The efficiency of activities undertaken by professional accountancy organizations is critical. In this regard, the Accounting Development Tool contains indicators and related questions to assess the level of professional accountancy organization development, including enquiries regarding the following: existence of a professional accountancy organization in the country and membership in IFAC; coordination mechanisms; the ability of professional accountancy organizations to comply with the statements of membership obligations, including the sufficiency of human and financial resources; existence of a code of ethics and whether this code is updated; and investigations, discipline and appeals, including the independence of committee members.

D. MAIN CROSS-CUTTING CHALLENGES IN THE IMPLEMENTATION OF STANDARDS AND GOOD PRACTICES

In addition to the issues and challenges already noted, there are other cross-cutting issues that need to be considered in building a strong MCE system, which are detailed in this section.

1. Independence

Independence allows regulators and supervisory entities to conduct their activities in an objective and fair manner. For example, the ESMA guidelines state that enforcers should have adequate independence from Government, issuers and auditors, other market participants and regulated market operators. The balance between independence and accountability, including a mechanism for appeals, needs to be considered.

The core principles of the International Forum of Independent Audit Regulators define independence as the ability to undertake regulatory activity and make and enforce decisions without external interference by those regulated. Principle five notes that audit regulators should have arrangements in place to ensure that inspectors are independent of the profession. In this regard, for example the European Commission states that a system of public oversight should be governed by non-practitioners who are knowledgeable in areas relevant to statutory audits.

Principle two of IOSCO states that regulators should be operationally independent and accountable in the exercise of their functions and powers.

2. Funding

IOSCO states that regulators should have a stable source of funding, which will enhance their independence. The Australian Securities and Investments Commission (ASIC), for example, is funded by the federal Government and the amount varies according to the policy priorities and budgetary constraints of the Government.

The International Forum of Independent Audit Regulators emphasizes the need for audit regulators to have a stable source of funding that is secure and free from influence by auditors and audit firms and sufficient to execute their powers and responsibilities.

Deloitte (2013) noted that existing funding models included a levy on listed companies and/or professional bodies and/or directly on audit firms. For example, PCAOB is funded primarily through annual fees assessed on public companies in proportion to their market capitalization and on brokers and dealers based on their net capital in and outside of the United States. In addition, PCAOB collects a registration fee and an annual fee from each registered public accounting firm. In Germany, the Financial Reporting Enforcement Panel is financed by levies on listed firms. The Panel has a staff of 16 full-time members, the majority of whom have a senior accounting and/or auditing background.

Jackson and Roe (2009), using a resource-based concept of public enforcement efficacy that measured the level of public resources that a country allocated to its financial regulators, scaled to either the economic size or population of the country, observed that higher

[33] Professional Accountancy Organization, 2013, Professional Accountancy Organization global development report – Mosaic: Memorandum of understanding to strengthen accountancy and improve collaboration, available at http://www.ifac.org/publications-resources/professional-accountancy-organization-global-development-report (accessed 30 July 2014).

budgets and greater staffing allowed regulators to perform their duties efficiently.[34]

3. Balance between transparency and confidentiality

Regulators need to observe confidentiality when handling a case and reviewing information. However, their procedures and resolutions need to be transparent and in many cases this means that information must be made public.

In this regard, principle four of the International Forum of Independent Audit Regulators states that audit regulators should have public accountability in the use of their powers and resources to ensure that they maintain their integrity and credibility. In addition, transparency should include the publication of annual work plans and activity reports, including the outcome of inspections, either in the aggregate or on an individual basis.

ESMA emphasizes that enforcers should periodically provide information to the public on their enforcement activities and coordination.

4. Staff competency

Understaffing and/or a lack of competent staff affect the ability of an enforcer to undertake its duties in an efficient and effective manner. This includes the lack of appropriate technology and the skills to use such technology. Continuous training is required to maintain professional capacities at the highest level of quality. In this regard, guideline two of ESMA states that enforcers should have sufficient human and financial resources and that human resources should be professionally skilled, experienced and sufficient in number. With regard to audit enforcement, staff carrying out reviews of the quality assurance systems of audit firms should have appropriate professional training, relevant experience in auditing and financial reporting and training in regulatory quality assurance reviews. Investigators should have analytical skills and knowledge of the industry and markets, and prosecutors should have a full set of legal and litigation skills and an understanding of financial markets.[35] Regulators in general, however, are not only understaffed but also not able to hire personnel with expertise comparable to that of regulated entities.

It is also important that enforcers establish professional standards and sanctions to be followed by their staff. The International Forum of Independent Audit Regulators states that audit regulators should have prohibitions in place against conflicts of interest by their governing bodies and staff and to ensure that confidential information is protected.

5. Cooperation and coordination

Cooperation and coordination are critical to ensure consistent regulatory requirements for substantially the same type of conduct and product generally and coherent regulation in different sectors. It is also important to have coordination with regard to sharing information or creating a joint registry of auditors and audit firms and in collaborations between domestic authorities and their foreign counterparts, taking into consideration confidentiality issues. Results from the pilot tests of the Accounting Development Tool show that many countries lack coordination among the main stakeholders involved in the corporate reporting chain.

In one example with regard to cooperation and regional integration, in 2011, the Accounting and Corporate Regulatory Authority of Singapore, with the independent audit regulators of Malaysia and Thailand, formed an informal cooperation group known as the Association of Southeast Asian Nations Audit Regulators Group, which holds periodic meetings with the four largest regional firms to discuss audit quality matters.[36]

Principle seven of the International Forum of Independent Audit Regulators states that audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. The Forum conducts cooperation efforts and has published a report summarizing the results of a global survey on the inspection of audit firms.[37] The European Group

[34] HE Jackson and MJ Roe, 2009, Public and private enforcement of securities laws: Resource-based evidence, *Journal of Financial Economics*, 93:207–238, available at http://www.sciencedirect.com/science/article/pii/S0304405X09000786 (accessed 30 July 2014).

[35] A Carvajal and J Elliott, 2009.

[36] Accounting and Corporate Regulatory Authority, 2013.

[37] International Forum of Independent Audit Regulators, 2014, Report on 2013 survey of inspection findings, available at http://www.ifiar.org/IFIAR-Global-Survey-of-Inspection-Findings.aspx (accessed 30 July 2014).

of Auditors' Oversight Bodies issued a guidance paper in 2009 establishing a common approach for cooperation within the European Union between the competent authorities of member States with respect to audit firms and auditor oversight, whereby each member State designates a single competent authority as a contact point for the sharing of information.[38]

The principles of IOSCO address measures concerning the sharing of information and the types of assistance between a regulator and its counterpart. For example, in the European Union, ESMA established the European Enforcers Coordination Sessions, a forum of 37 enforcers from European Union member States and two countries in the European Economic Area. The forum constitutes the largest network of enforcers with supervision responsibilities in IFRS globally. Through the forum, European enforcers share and compare their practical experiences. In 2005, ESMA established an internal database as a platform for sharing information on a continuous basis.

E CONCLUSION

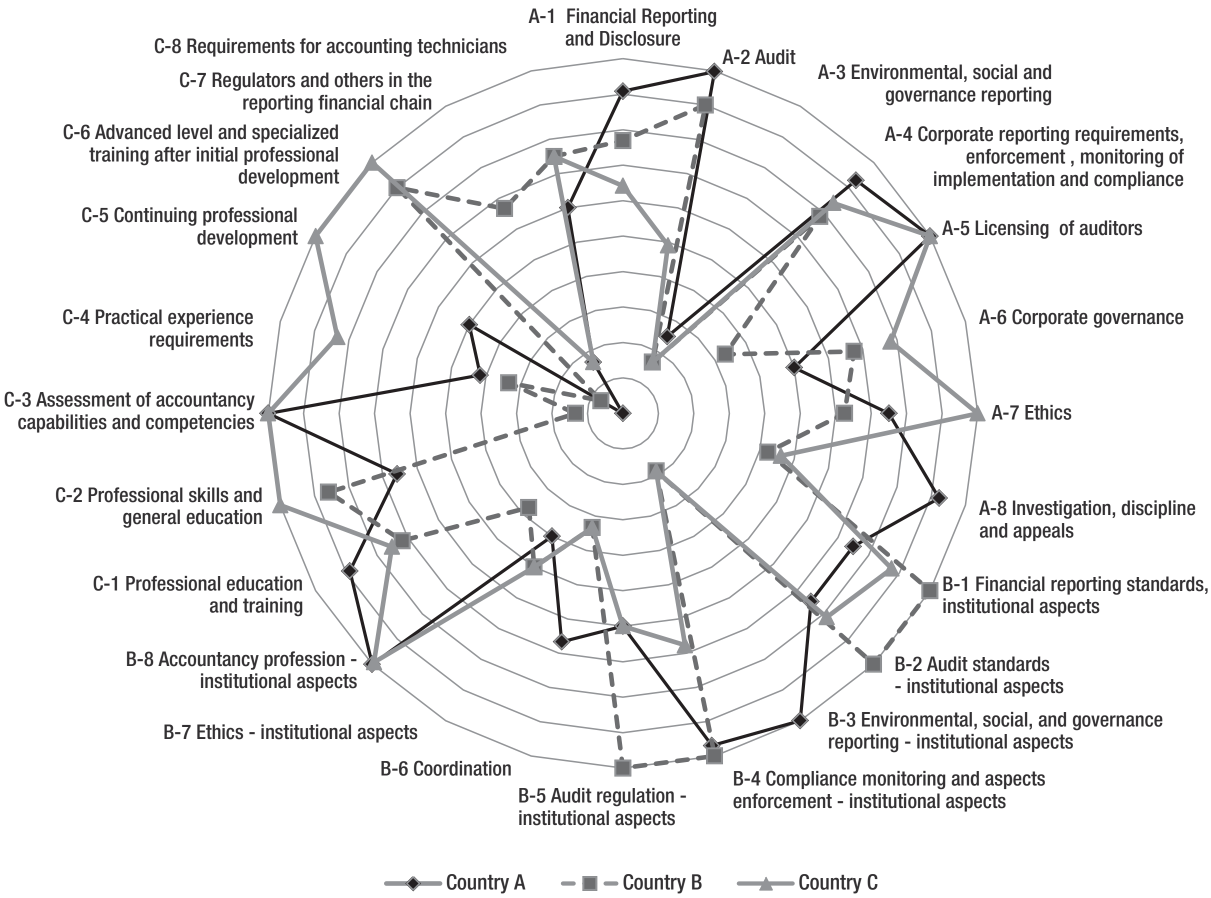
To ensure the proper implementation of international standards and codes, countries need to monitor the compliance and enforcement of requirements for companies, audit firms and professional accountants. Enforcers require clear responsibilities and adequate powers and mechanisms to investigate, detect deviations and, when necessary, impose enforcement actions and sanctions. They also require sufficient and competent human and financial resources. In addition, they should be independent while remaining accountable and maintaining confidentiality standards. Furthermore, coordination among key stakeholders at national levels and collaboration with other enforcers at the international level are indispensable. Additional research to analyse the strengths and weaknesses of the enforcement systems in individual jurisdictions is important for the design of future MCE-related measures. Technical assistance and capacity-building activities to strengthen legal and institutional frameworks in developing countries is also important.

[38] European Group of Auditors' Oversight Bodies, 2009, Guidance paper on the cooperation between competent authorities in the European Union, available at http://ec.europa.eu/internal_market/auditing/egaob/index_en.htm (accessed 30 July 2014).

APPENDIX I.1 ACCOUNTING DEVELOPMENT TOOL SCORES FOR THREE SAMPLE COUNTRIES

The following spider graph presents the UNCTAD-ISAR Accounting Development Tool scores for three sample countries for 24 quantitative indicators. Indicators A-4, A-5, A-7, A-8, B-4, B-5, B-6, B-7 and B-8 are directly linked to MCE systems.

Figure Accounting Development Tool scores for three sample countries



CHAPTER II. CASE STUDY: AUSTRALIA

This case study presents an overview of MCE of accounting and reporting standards and codes in Australia.[39] Section A provides a brief introduction to the economic setting and the structure of the Government and legal system. The stock exchange and financial system are also described, and major participants in the financial reporting system – rule-makers, financial statement preparers and rule enforcers – are identified.

Section B provides an explanation of the system for promoting compliance in the Australian framework for financial reporting. It outlines the roles and activities of the national stock exchange (Australian Securities Exchange (ASX)), securities market regulator (ASIC) and financial reporting oversight body (Financial Reporting Council (FRC)). Section C continues the discussion by examining the roles of these bodies in monitoring compliance in relation to the auditing and assurance of financial reports. Section D examines the roles and activities of professional accounting bodies (Chartered Professional Accountants (CPA) Australia, Chartered Accountants Australia and New Zealand (CAANZ) and Institute of Public Accountants (IPA)) in relation to compliance and enforcement. Section E concludes the study with observations about the financial reporting framework in Australia, highlighting issues that may be of interest to regulators in other countries.

A. INTRODUCTION

This section provides information about the Government, economic setting and legal and financial system in Australia. It also identifies the rule-makers, financial statement preparers and rule enforcers in the financial reporting framework.

1. Economic setting

Australia currently has a population of approximately 23 million. The economy has been growing by around 3 per cent per annum since 1990. In 2012–2013, the gross domestic product (GDP) was $A1.525 billion. Australia has a low inflation rate (around 2.5 per cent over the past 15 years) and the unemployment rate is below 6 per cent.[40] The economic wealth of Australia is based mainly on mining and resources, agricultural products and education, travel and professional and financial services. In 2013, iron ore, coal, gas, gold, petroleum and aluminium were major exports. Other significant exports were wheat, beef and education services. Major imports were manufactured goods (motor and other vehicles, computers and telecommunications equipment), petroleum and freight, travel and transport services.[41]

2. Government and legal system

Australia was settled as a colony of Britain in 1788. Over time, six states and two territories were established, each with their own democratically elected government. The states and territories voted to create a federation in 1901, the Commonwealth of Australia, which has an elected Government, a public service to support the Government and an independent judicial system. The legal system of the states and territories and in turn the Commonwealth was based on the English common law system. Today, business activity is governed by both common law and statute law. A hierarchy of courts operates within each state and territory, and the High Court is the highest court in the judicial system.[42]

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39 This case study was prepared for UNCTAD by Ann Tarca, Professor of Accounting, University of Western Australia. The author thanks Con Abbot for valuable research assistance and her professional colleagues for advice and comments. Feedback on the case study from Prerana Agrawal, Peter Carlson, Elizabeth Carson, Assunta Corbo, Bruce Dodd, Regina Fikkers, David Gilchrist, John Preiato, Jan McCahey, Andrew Stringer and Michael Tarca is gratefully acknowledged.

40 PricewaterhouseCoopers, 2014, Doing business in Australia: An introductory guide, available at http://www.pwc.de/de/internationale-maerkte/assets/doing-business-in-australia.pdf (accessed 4 January 2016).

41 Australian Bureau of Statistics, 2012, 2012 year book Australia, available at http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1301.0 (accessed 13 July 2014). For more economic information, see Australian Bureau of Statistics, 2015, Key economic indicators database, available at http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1345.0?opendocument?opendocument#from-banner=LN.

42 Ibid.

Both the Commonwealth and the state governments have the power to create laws affecting how business operates. The financial reporting framework discussed in this case study primarily reflects the laws made and administered by the Commonwealth Government. Under the Constitution, the Commonwealth Government has power to legislate in relation to a range of subjects, including corporations, interstate and international trade and commerce, taxation, communications, banking, insurance and industrial disputes.[43]

Business activity is a fundamental part of Australia's economic wealth and prosperity. Business takes places in a setting underpinned by democratically elected governments and a strong independent legal system. World Bank rankings place Australia among the top 10 countries for measures such as rule of law and control of corruption and among the top 20 countries for regulatory quality.[44]

3. Equity market and financial system

Australia features a well-developed capital market and financial services industry. The World Economic Forum ranks Australia fifth out of 57 of the world's leading financial systems and capital markets.[45] The equity market is the eighth largest in the world and the second largest in the Asia and the Pacific region. The foreign exchange market is the seventh largest in the world (based on global turnover). The Australian dollar is the fifth most traded currency and the Australian dollar/United States dollar is the fourth most traded currency pair.

The national stock exchange ASX is operated by the listed company ASX Limited. As at 30 June 2013, ASX had 2,185 listed companies and a market capitalization of $A1.4 trillion. The Morgan Stanley Capital Index ranks ASX as the eighth largest stock exchange in the world. ASX has a large and diversified customer base, with around 150 participants in cash, equity and derivative markets and four exchanges for clearing and settlement services. ASX customers include corporations, superannuation (pension) funds, fund managers and retail investors.[46]

The market attracts global investors and many multinational financial services providers. The equity market features around 40 per cent foreign investors, 40 per cent domestic institutional investors and 20 per cent retail investors.[47] ASX is the market regulator and, in this role, works closely with the securities market regulator, ASIC, created by the Commonwealth Government under the ASIC Act.[48] The role and activities of ASIC are discussed in sections B and C.

The Australian financial system includes banks, building societies, credit unions, merchant banks and finance companies, superannuation funds, life and non-life insurance companies and investment funds. Monetary policy is the responsibility of the Government and the central bank, the Reserve Bank of Australia. Financial institutions are licensed and supervised by the Australian Prudential Regulation Authority (APRA) an entity created by the Commonwealth Government under the APRA Act (see section B).[49]

4. Financial reporting framework

There are many parties participating in the framework for financial reporting in Australia. The term "financial reporting framework" means the environment in which the preparation, audit and release of financial reports occurs. Compliance with this framework means meeting the requirements of law and of accounting, auditing and ethical standards. Enforcement refers to the activities of bodies to ensure compliance with laws and standards.[50] Appendix I.1 lists a number of entities that are participants in the framework and the legislation that underpins the framework. Participants include rule-makers, financial statement preparers and rule enforcers. The roles and activities of these entities

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43 King and Wood Mallesons, 2014, Guide to doing business in Australia 2014, available at http://www.mallesons.com/Documents/A-guide-to-doing-business-in-Australia-EN.pdf (accessed 1 August 2014).

44 The Worldwide Governance Indicators database, available at http://www.govindicators.org.

45 King and Wood Mallesons, 2014.

46 ASX Limited, 2013, *Annual Report 2013* (Melbourne, Australia), available at http://www.asx.com.au/documents/media/ASX_annual_report_2013.pdf (accessed 1 July 2014). For more information about ASX, see http://www.asx.com.au.

47 King and Wood Mallesons, 2014.

48 For more information, see http://www.asic.gov.au.

49 For more information, see http://www.apra.gov.au.

50 For example, the IOSCO principles related to enforcement call for securities market regulators to have comprehensive inspection, investigation and surveillance powers (principle eight) and comprehensive enforcement powers (principle nine) and state that the regulatory system should ensure the effective and credible use of inspection, investigation, surveillance and enforcement powers and the implementation of an effective compliance programme (IOSCO, 2003, Objectives and principles of securities regulation, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (accessed 15 August 2014)).

in relation to MCE of financial reporting requirements are detailed in the subsequent sections of this chapter.

Rule-makers: Government, stock exchange, standard setters and professional accounting bodies

Several parties have issued regulations affecting the preparation of financial reports and the release of information by companies. The Corporations Act, promulgated by the Commonwealth Government, requires the production and lodgement of financial reports. The Act makes the application of accounting standards, issued by the Australian Accounting Standards Board (AASB), mandatory for reporting entities (including listed companies). Statutory financial statements must be audited in accordance with auditing standards issued by the Australian Auditing and Assurance Standards Board. Professional accounting practice is guided by the standards of the Accounting Professional and Ethical Standards Board.[51]

In addition, ASX has issued listing rules, which affect the release of information by listed companies. ASX has also issued corporate governance principles and guidance to set out recommended corporate governance practices for listed entities that are "likely to achieve good governance outcomes" and meet investor expectations.[52] The professional accountancy bodies, CPA Australia, CAANZ and IPA, have regulations and professional guidance statements that are binding on members and thereby affect financial reporting practices.

Companies, directors and officers of reporting and non-reporting entities

The Corporations Act requires all public companies, large proprietary companies and small proprietary companies controlled by foreign entities to lodge an audited annual financial report and a reviewed half-year financial report. The financial statements included in reports are prepared in compliance with Australian accounting standards. The Corporations Act specifies the financial reporting obligations of companies and their officers. The board of directors of listed entities must ensure that reports comply with accounting standards, and the chief executive officer and chief financial officer must sign off on the reports before they are presented to the directors.

Public sector entities that are reporting entities[53] must prepare general purpose financial statements in compliance with all Australian accounting standards under the Financial Management and Accountability Act, the Commonwealth Authorities and Companies Act and the Corporations Act.[54]

Non-reporting entities produce special purpose financial reports that may comply with fewer standards, as per the Corporations Act.[55] Non-reporting entities

[51] For more information about AASB, the Australian Auditing and Assurance Standards Board and the Accounting Professional and Ethical Standards Board, see http://www.aasb.gov.au, http://www.auasb.gov.au and http://www.apesb.org.au, respectively.

[52] ASX Corporate Governance Council, 2014, *Corporate Governance Principles and Recommendations* (Sydney, Australia), available at http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf (accessed 1 July 2014).

[53] Reporting entities are defined as "all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources" (Australian Accounting Research Foundation, 1990, Statement of accounting concepts, available at http://www.aasb.gov.au/Pronouncements/Statements-of-accounting-concepts.aspx (accessed 1 September 2014)).

[54] Australian National Audit Office, 2009. *Preparation of Financial Statements by Public Sector Entities* (Canberra). For more information about the Office and better practice guides (which "aim to improve public administration by providing a mechanism whereby better practices employed in organizations are recognized and promulgated to all Australian Government entities. This can involve examining practices in the public or private sectors, in Australia or overseas. Our emphasis is to identify, assess and articulate good practice from our knowledge and understanding of the public sector as well as areas where improvements are warranted"), see http://www.anao.gov.au and http://www.anao.gov.au/Publications/Better-Practice-Guides, respectively.

[55] The applicable accounting standards are Standard no. 101: Presentation of financial statements; Standard no. 107: Cash flow statements; Standard no. 108: Accounting policies, changes in accounting estimates and errors; Standard no. 1031: Materiality; and Standard no. 1048: Interpretation and application of standards (ASIC, 2005, Reporting requirements for non-reporting entities, Regulatory Guide 85, available at http://download.asic.gov.au/media/1239893/rg85.pdf (accessed 4 January 2016); CAANZ, 2013, Enhancing not-for-profit annual and financial reporting, available at: http://www.charteredaccountants.com.au/notforprofits (accessed 1 September 2014)). The Australian Charities and Not-for-profits Commission is the independent national regulator of charities, set up to maintain, protect and enhance public trust and confidence in the sector through increased accountability and transparency; support and sustain a robust, vibrant, independent and innovative not-for-profit sector; and promote the reduction of unnecessary regulatory obligations on the sector. It administers a range of legislation for the sector. For more information, see http://www.acnc.gov.au.

may include private companies and some not-for-profit entities. The reporting framework for the latter reflects their legal form. For example, registered charities report under the Charities and Not-for-profits Commission Act, companies limited by guarantee report under the Corporations Act and cooperatives report under various state laws.

Rule enforcers: Auditors, professional accounting bodies, government oversight bodies and regulators

There are several parties involved in the enforcement of financial reporting requirements, based on power given by law or through professional accounting bodies. In many countries, auditors are recognized as having a key role in enforcing the requirements of accounting standards[56] and this is the situation in Australia. Audited financial statements are required for listed entities under the Corporations Act. Public sector entities are also required to provide audited financial statements.[57] In the not-for-profit sector, large companies limited by guarantee (annual revenue greater than $A1 million) and larger registered charities must also provide audited financial statements.[58]

Under the Corporations Act[59], an auditor is required to:

(a) Form an opinion about whether a financial report complies with the accounting standards and gives a true and fair view, as well as about other certain matters (subsection 307), and report to members (subsection 309)

(b) Conduct the audit in accordance with auditing standards (subsection 307A)

(c) Meet independence requirements (including professional standards) and give the independence declaration of directors and auditors (subsection 307C)

(d) Report certain suspected contraventions of the Corporations Act to ASIC (subsection 311)

The activities of auditors are, in turn, overseen by other bodies. The main bodies responsible for monitoring and reviewing the work of auditors are ASIC, FRC and the three professional accounting bodies. Many jurisdictions appoint government agencies to provide oversight of stock markets and financial reporting.[60] The Australian regulatory framework is based on a twin peaks approach, with APRA responsible for the prudential regulation of financial sector companies and ASIC responsible for the conduct of market participants and the quality of their disclosure. ASIC describes the roles of the entities as follows: APRA has the power to regulate the information asymmetry problem by setting and enforcing standards of prudential behaviour for all institutions involved in deposit taking, insurance and superannuation; and ASIC has the power to regulate market integrity and consumer protection with the objective of providing market fairness and consumer confidence.[61]

B. MONITORING COMPLIANCE WITH THE FINANCIAL REPORTING FRAMEWORK

Corporate law requires the production of audited financial reports in compliance with Australian accounting standards. Monitoring compliance with the Corporations Act is primarily the function of ASIC. Other parties involved in activities that may affect compliance with financial reporting requirements include APRA and ASX.

1. Australian Securities and Investments Commission

ASIC is the securities market regulator with power granted under the ASIC Act to regulate corporations, markets and financial services. The Act states that ASIC should:[62]

(a) Maintain, facilitate and improve the performance of the financial system and entities within it in the interests of commercial certainty, reducing business costs, increasing efficiency and developing the economy

56 Federation of European Accountants, 2001.

57 Australian National Audit Office, 2009.

58 CAANZ, 2013.

59 ASIC, 2014, Audit quality: The role of directors and audit committees, Information Sheet 196, available at http://download.asic.gov.au/media/1338914/info196-Audit-quality-published-17-March-2014.pdf (accessed 4 January 2016).

60 P Brown, J Preiato and A Tarca, 2014.

61 J Cooper, 2006, The integration of financial regulatory authorities – the Australian experience, presented at the Securities and Exchange Commission of Brazil Thirtieth Anniversary Conference, Rio de Janeiro, Brazil, 4–5 September.

62 ASIC, 2013, Annual report 2012–2013, available at http://download.asic.gov.au/media/1311019/ASIC-Annual-Report-2012-13-complete.pdf (accessed 1 July 2014).

(b) Promote confident and informed participation by investors and consumers in the financial system

(c) Administer the law effectively and with a minimum of procedural requirements

(d) Receive, process and store – efficiently and quickly – the information that it receives

(e) Make information about companies and other bodies available to the public as soon as practicable

(f) Take whatever action it can, and which is necessary, to enforce and give effect to the law

ASIC has a broad remit; it regulates companies and financial services and promotes investor, creditor and consumer protection under 10 separate legislative acts. ASIC is responsible for regulation in the areas of investors and financial consumers, markets and registry and licensing services. ASIC priorities are listed as confident and informed investors and financial consumers; fair and efficient financial markets; and efficient registration and licensing.[63]

In 2013, the resources of ASIC were allocated as follows: 42 per cent to the first priority; 32 per cent to the second; and 26 per cent to the third. To achieve its priorities, ASIC engages in a number of activities, including engagement, surveillance, guidance, education, enforcement and policy advice. In 2013, the budget of ASIC for staff and supplier costs was $A341.2 million, which was allocated as follows:[64]

(a) Enforcement (39 per cent)

(b) Registry (client inquiries, data management, licensing and registration; 24 per cent)

(c) Surveillance (19 per cent)

(d) Engagement with industry and stakeholders (8 per cent)

(e) Policy advice (4 per cent)

(f) Guidance and education (3 per cent each).

The role of ASIC as a regulator of financial reporting and auditing falls largely under the second priority (fair and efficient financial markets). It is involved in the surveillance of listed entities, prospectuses, financial reporting and auditing, insolvency practitioners and financial market infrastructure, as well as market and participant supervision. In 2013, more than 200 staff members were involved in surveillance work, with about 38 of those involved in financial reporting and auditing surveillance.[65] The number of staff involved in prior years was 40 in 2012 and 33 in 2011. Other staff members were involved in monitoring corporate disclosure, among other activities (49 in 2013, 54 in 2012 and 58 in 2011).[66]

According to ASIC Information Sheet 151, the ASIC Act directs ASIC to “take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it”. ASIC uses its enforcement powers to detect and deal with unlawful conduct, to recover money in appropriate circumstances and sometimes to prevent unlawful conduct.

The approach of ASIC to enforcement follows several steps. First, potential breaches of law are detected or brought to its attention in a number of ways, such as reports of misconduct from members of the public, referrals from other regulators, statutory reports from auditors, insolvency practitioners and licensees and through its monitoring and surveillance work. Second, the reported matter is assessed. Third, a formal investigation is conducted, if considered necessary and appropriate. Fourth, appropriate remedial action is determined. Resolution may involve punitive, protective, preservative and corrective actions, as well as compensation and a negotiated resolution. Finally, as noted in ASIC Information Sheet 151, ASIC publishes the outcomes in an ASIC enforcement outcomes report every six months.[67]

63 Ibid. For more information about the role, priorities and powers of ASIC, see http://www.asic.gov.au/our-role.

64 Ibid. In 2013, ASIC received $A367 million in appropriations and other revenue from the Commonwealth Government, an increase from $A339 million in 2012 and $A345 million in 2011. In 2010, the appropriation was $A381 million. In 2013, ASIC raised $A717 million in fees and charges for the Government, an increase from $A664 million in 2012, $A622 million in 2011 and $A582 million in 2010. ASIC operating expenses were $A411 million in 2013, $A384 million in 2012, $A385 million in 2011 and $A387 million in 2010 (see appendix II.2).

65 Ibid.

66 Ibid. In 2013, the total number of ASIC staff members was 1,844 (full-time equivalent positions). Staff numbers fluctuated somewhat over prior years (1,738 in 2012, 1,893 in 2011 and 1,932 in 2010) according to ASIC budget, strategy and operating requirements (see appendix II.2).

67 For more information about ASIC investigations and enforcement, see http://asic.gov.au/about-asic/asic-investigations-and-enforcement/.

Lodgement

ASIC monitors the lodgement of annual reports by companies and other entities that are required to lodge reports. In 2012–2013, ASIC obtained and issued 26 civil orders to enforce notices to require compliance with annual reporting obligations. ASIC reported that an additional 49 companies had complied with their lodgement requirements following ASIC intervention.[68]

Review of financial reports

ASIC conducts a proactive review programme, which involves reviewing the financial reports of a number of listed and unlisted entities each year (selected from the population in 2013 of 1,983 listed entities and 26,000 unlisted entities). The largest 500 listed entities are reviewed every three years on average and the other 1,500 (non-foreign company) listed entities are reviewed every 12 years on average. About 300 unlisted entities with larger numbers of users are reviewed every 12 years on average.[69]

In 2013, ASIC reviewed the 2013 financial reports from 280 listed and other public interest entities. The number of reports reviewed in prior years was 450 in 2012, 500 in 2011 and 480 in 2010 (see appendix II.2). In 2013, ASIC reported that the quality of financial reporting in Australia was comparable with other major jurisdictions.[70] However, ASIC was concerned that in some cases there was inadequate assessment regarding the impairment of assets and inappropriate recognition of revenue.

Enforcement – financial reporting

The enforcement process follows the review of financial statements to evaluate their compliance with accounting standards. The review process may lead to specific enquiries being made of a company or other entity. As a result of such enquiries, changes may be made to financial reports. However, this does not occur in all cases.

In 2013, ASIC reported that it had made enquiries in relation to impairment, revenue recognition, consolidation of other entities, amortization of intangibles, segment reporting and operating and financial review disclosure. Overall, there were enquiries to 70 entities on 100 matters. The outcomes of these enquiries were that eight entities made material restatements of reported net assets and profits, three entities agreed to make additional material disclosures and 12 enquiries were concluded without material change to the financial reporting of the entities.[71]

In 2013, ASIC did not name the companies that were the subjects of its enquiries. However, it reported on details of information collected and areas of concern, and this report was publicly available on its website.[72] Providing this report and publicizing the information from a financial reporting review is part of a strategy to inform and educate people involved in financial reporting about the views of ASIC regarding correct financial reporting, or reporting in compliance with the requirements of accounting standards. The underlying assumption is that the ASIC enquiries lead to the identification of problems, changes to financial reports in some cases, publicity about what is required by ASIC and, in turn, improved compliance with accounting standards and higher quality financial reports.

Enforcement outcomes – publicity

ASIC publicizes various enforcement outcomes. For example, the 2013 annual report lists a number of investigations, civil proceedings and actions against individuals (for example banned from acting and removed from roles). Other enforcement outcomes included actions against auditors or liquidators (seven each in 2012 and 2013) and the issue of enforceable undertakings (22 in 2012 and 20 in 2013).[73]

Many of the enforcement outcomes relate to the broad remit of ASIC, not specifically to financial reporting and auditing. However, the release of this information signals to all in the business community that ASIC is an active regulator and has the ability to successfully pursue enforcement actions against companies, directors and auditors.

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68 ASIC, 2013.

69 Ibid.

70 ASIC, 2014, ASIC enforcement outcomes: July to December 2013, Report 383, available at http://download.asic.gov.au/media/1344494/rep383-published-11-February-2014.pdf (accessed 4 January 2016).

71 Ibid.

72 Ibid. See, for example comments by ASIC about asset values and impairment testing in its report on enforcement outcomes.

73 ASIC, 2013. An enforceable undertaking is an administrative settlement used by ASIC as an alternative to civil court action or other administrative actions (ASIC, 2012, Enforceable undertakings, Regulatory Guide 100, available at http://download.asic.gov.au/media/2976014/rg100-published-19-february-2015.pdf (accessed 4 January 2016)).

International activities

Enforcement of national law is generally carried out by national bodies, empowered by legislation and funded by the Government. However, it is common for national regulators to work cooperatively with other national and regional bodies on matters of common interest. Through international relationships, regulators can address common problems in a similar way. They can learn from each other about issues and problems and develop suitable solutions. ASIC has worked with ESMA and IOSCO on relevant issues.[74]

The expertise of the regulator means that it may make recommendations to the Government on policy matters. With a working relationship between officers of ASIC and those in other government departments and at ASX, ASIC is in a position to provide input regarding policy developments in relation to any areas of its expertise, including monitoring financial reporting and auditing compliance.[75]

2. Australian Prudential Regulation Authority

A second major government regulator active in the financial system is APRA. APRA is the regulator of banks, credit unions, building societies, insurance companies and superannuation funds and is funded largely by the industries it supervises. APRA currently supervises institutions holding $A4.5 trillion in assets for Australian depositors, policyholders and superannuation fund members.

APRA describes its mission as establishing and enforcing prudential standards and practices to ensure financial promises made by institutions are met within a stable, efficient and competitive financial system.[76] APRA has the power to regulate financial institutions through authorizing and licensing powers, supervision and monitoring powers and power to act in circumstances of financial difficulties to protect depositors, policyholders and superannuation fund members.[77]

Although APRA is an important regulator in its own right, its primary activities are not related to financial reporting to external parties. For many large financial institutions (including banks and insurance companies), these matters fall under the Corporations Act and are subject to enforcement by ASIC. ASIC and APRA work together to achieve their objectives. They have a memorandum of understanding and established procedures and communications channels to facilitate this process.[78] In addition, they are members (with the Reserve Bank and Commonwealth Department of the Treasury) of the Council of Financial Regulators, an informal coordinating body that enables the entities to discuss regulatory issues of common interest.[79]

3. Australian Securities Exchange

The objective of ASX is to provide a fair, well-informed market for financial securities and an internationally competitive market. ASX issues operating and listing rules that are binding on all listed entities. The rules govern listing, quotation, market information, reporting, disclosure, trading and settlement, administration, general supervisory and other matters. The listing rules are enforced by ASX through its subsidiary company ASX Compliance Limited.[80] ASX Limited, the listed company that operates the exchange, is supervised by ASIC.

Financial reporting compliance under the Corporations Act is generally the domain of ASIC. However, some of the ASX listing rules impact on company reports and disclosures. For example, the continuous disclosure rules (listing rules 3.1 to 3.1B) require listed entities to disclose market sensitive information to ASX as soon as they become aware of the information (subject to limited carve outs for private and incomplete information). Following a co-regulatory approach, the continuous disclosure rules are enforced by ASIC (subsection 674 of the Corporations Act) and by ASX. There are significant penalties for non-compliance. For example, in 2014, ASIC took action against Newcrest Limited and the company was fined $A1.2 million

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74 For more information about the international relationships of ASIC, see http://asic.gov.au/about-asic/what-we-do/international-activities/ (accessed 4 January 2016).

75 In 2013, ASIC raised a number of law reform proposals, but they did not relate directly to financial reporting (ASIC, 2013).

76 APRA, 2014, About APRA, available at http://www.apra.gov.au/aboutapra/Pages/default.aspx (accessed 13 September 2014); APRA, 2013, Annual report 2013, available at http://www.apra.gov.au/AboutAPRA/Publications/Pages/Archived-APRA-Annual-Reports.aspx (accessed 4 January 2016).

77 J Cooper, 2006.

78 A copy of the memorandum of understanding is available at http://asic.gov.au/about-asic/what-we-do/our-role/other-regulators-and-organisations/ (accessed 4 January 2016).

79 For more information about the Council of Financial Regulators, see http://www.cfr.gov.au.

80 ASX Limited, 2013.

by the Federal Court for breach of the continuous disclosure laws.[81]

ASX also influences financial reporting and auditing through the ASX Corporate Governance Council. The Council comprises 21 business, investment and shareholder groups whose role is to oversee the ASX corporate governance principles and recommendations, which provide guidance for listed companies in relation to corporate governance best practices. They are structured around, and seek to promote, the following central principles: lay a solid foundation for management and oversight; structure the board to add value; act ethically and responsibly; safeguard integrity in corporate reporting; make timely and balanced disclosure; respect the rights of security holders; recognize and manage risk; and remunerate fairly and responsibly.[82]

The principles are not mandatory but apply on the basis of if not, why not.[83] Listed companies are expected to comply with the principles or explain why they have not done so. The introduction of the principles has led to changes in firm governance that may be argued to impact on financial reporting and auditing.[84] For example, ASX guidance promotes a governance structure with a separate chair and chief executive officer, more independent directors, greater use of board committees and greater engagement with external auditors through the audit committee.

[81] The court found that Newcrest Limited contravened its continuous disclosure obligations under subsection 674(2) of the Corporations Act as the company had briefed analysts about levels of production and capital expenditure before the information was generally available to the market (ASIC, 2014, Newcrest ordered to pay $1.2 million for breaching continuous disclosure laws, available at http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-148mr-newcrest-ordered-to-pay-12-million-for-breaching-continuous-disclosure-laws/ (accessed 1 September 2014)).

[82] ASX Corporate Governance Council, 2014. The Council brings together various business, shareholder and industry groups who may offer insight and expertise on governance issues from the perspective of their particular stakeholders. Since 2003, the Council has developed and issued recommendations on the corporate governance practices to be adopted by ASX listed entities designed to promote investor confidence and assist listed entities to meet stakeholder expectations. For more information, see http://www.asx.com.au/regulation/corporate-governance-council.htm.

[83] Ibid. Companies in the ASX All Ordinaries Index (Standard and Poor Top 300) are required by a listing rule to have an audit committee.

[84] P Brown, W Beekes and P Verhoeven, 2011, Corporate governance, accounting and finance: A review, *Accounting and Finance*, 51(1):96–172.

C. MONITORING COMPLIANCE WITH THE AUDITING AND ASSURANCE FRAMEWORK

Auditing and assurance activities are a key part of the financial reporting framework. Several parties are involved in monitoring audit practices and promoting compliance with relevant legislation, auditing standards and professional guidance. This section discusses the activities of ASIC and FRC. In addition, professional accounting bodies play an important role, as discussed in section D.

1. Australian Securities and Investments Commission

Australia has comprehensive legislative and professional requirements about auditors and audit practices.[85] The main legislation is the Corporations Act, which specifies the requirements for entities to provide audited financial statements, states requirements for the registration of auditors and makes Australian auditing standards (issued by the Australian Auditing and Assurance Standards Board) enforceable as law. Auditing standards also require auditors to follow ethical standards issued by the Accounting Professional and Ethical Standards Board. Under the Corporations Act, ASIC is responsible for the enforcement of audit requirements. Professional accounting bodies are also involved in the process of setting and enforcing professional standards, described in Australia as a co-regulatory regime.[86]

Amendments to the Corporations Act in the Corporate Law Economic Reform Programme (Audit Reform and Corporate Disclosure) Act, 2004 (CLERP 9), made compliance with auditing standards mandatory. They also brought some areas of regulation of auditors and audit firms (that were not regulated or were previously self-regulated through professional accounting bodies) within the ambit of statute law. For example, CLERP 9 sought to improve auditor independence by introducing limits on the appointment of auditors in certain circumstances, requiring the disclosure of remuneration for non-

[85] FRC, 2013, Annual report 2012–2013, available at http://www.frc.gov.au/files/2014/02/FRC_Annual_Report_2012-13.pdf (accessed 1 July 2014).

[86] Ibid.

audit services and requiring mandatory audit partner rotation after five years.[87] Following the CLERP 9 amendments, the responsibilities of ASIC for audit oversight were enhanced, and include the registration of auditors, assessing whether auditors meet the registration requirements and receiving the annual statements of auditors (providing ASIC with up-to-date information) for monitoring purposes.[88] As part of meeting these new responsibilities, ASIC began audit firm inspections. The frequency of inspections reflects the size of the audit firm and the importance of the entities they audit. The four largest audit firms (PricewaterhouseCoopers, KPMG, Deloitte and Ernst and Young) conduct audits for 95 per cent of listed entities (based on market capitalization). Inspections of these firms are conducted every 1.5 years on average. Second-tier audit firms are auditors for 4 per cent of listed entities and are inspected every 2.5 years on average. The remaining 74 audit firms are reviewed every 10.3 years on average.[89]

Audit firm inspections

In 2013, ASIC conducted surveillance of the population of 86 audit firms and inspected 16 audit firms, focusing on audit engagement file reviews and quality control systems. ASIC also conducted surveillance of individual audits and auditors, based on market intelligence and other information.[90] In 2010–2013, the number of registered company auditors was in the range of 4,852 to 5,207. ASIC inspected 21 audit firms in 2011 and 19 in 2010 (see appendix II.2).

The ASIC audit inspection programme report for the 18 months to 31 December 2013 reported on the results of risk-based inspections of audit firms, noting that 454 key audit areas had been reviewed in 107 audit files at audit firms of different sizes. Areas reviewed included impairment of assets and other areas involving significant estimates and judgements. ASIC found that in 20 per cent of the key audit areas, auditors did not obtain reasonable assurance that the financial report as a whole was free from material misstatement. ASIC noted that this level was similar to that reported in the prior period ending June 2012.[91]

Audit inspections are a sensitive matter because audit firms have, in their view, completed their work to high professional standards. Therefore it is in a firm's best interests to discuss matters in the audit inspection reports with ASIC and to address these matters. ASIC has pointed to three broad areas that require improvement by audit firms, as follows: sufficiency and appropriateness of audit evidence obtained by auditors; level of professional scepticism exercised by auditors; and ensuring appropriate reliance on the work of experts and other auditors. An outcome of this audit inspection process is that ASIC has asked the largest six audit firms (PricewaterhouseCoopers, KPMG, Deloitte, Ernst and Young, Grant Thornton and BDO) to prepare action plans to improve audit quality and the consistency of audit execution. The effect of these plans will be reviewed in future ASIC inspections.[92]

Audit inspection reports allow ASIC to identify areas in which they believe auditors should improve their practices. The reports also specify the areas of focus in future audit inspections. In 2013, the report outlined actions that audit firms, directors and audit committees, standard setters and accounting bodies could take to support audit quality. The reports are thus used to inform and educate auditors and others involved in the audit function with the aim of changing behaviour and improving audit quality. Audit inspection reports, covering firms in general (individual firms are not identified), are made public and posted on the ASIC website. Reports on individual firms are provided on a confidential basis to firms.

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87 P Brown and A Tarca, 2005, It's here, ready or not: A review of the Australian financial reporting framework, *Australian Accounting Review*, 15(36):68–78; K Houghton, M Kend and C Jubb, 2013, The CLERP 9 audit reforms: Benefits and costs through the eyes of regulators, standard setters and audit service suppliers, *Abacus*, 49(2):139–160.

88 ASIC, 2012, Auditor registration, Regulatory Guide 180, available at http://download.asic.gov.au/media/1240997/rg180-published-28-september-2012.pdf (accessed 4 January 2016). The CLERP 9 amendments also imposed obligations on auditors to report breaches of the Corporations Act to ASIC. Auditors must notify ASIC about matters that they have reasonable grounds to suspect amount to a significant contravention of the Corporations Act. Auditors must also notify ASIC of matters that are not a significant contravention but that may not be adequately dealt with, by commenting on it in their reports or bringing it to the attention of directors.

89 ASIC, 2013.

90 Ibid.

91 ASIC, 2014, Audit inspection programme report for 2012–2013, Report 397, available at http://download.asic.gov.au/media/1344614/rep397-published-27-June-2014.pdf (accessed 4 January 2016). For copies of audit inspection reports, see http://www.asic.gov.au/regulatory-resources/find-a-document/?filter=Report&auditors=on.

92 Ibid.

Education

ASIC has issued several reports aimed at improving audit practices. In 2013, ASIC issued reports, regulatory guides and a consultation paper related to auditors. The consultation paper sought views on whether ASIC should fundamentally change its approach to consenting to the resignation, removal and replacement of auditors and, for example Regulatory Guide 34 outlined auditor obligations when reporting to ASIC.[93] Another initiative was to suggest to the chairs of the audit committees of companies that they request reports of ASIC inspection findings from the auditors of their companies for review and action by the committees. As noted in ASIC Information Sheet 196, in 2014, ASIC issued guidance for company directors and audit committee members to explain their role in promoting audit quality.

Enforcement

ASIC sees auditors as gatekeepers (together with directors, company officers, insolvency practitioners and others) who have a key role in ensuring that investors are confident and informed and that Australia's financial markets are fair and efficient. ASIC has stated that it will take enforcement action against any of these parties if they fail to perform their duties with sufficient honesty, diligence, competence or independence.[94]

For example, ASIC takes enforcement action against auditors associated with corporate collapses. In 2013, ASIC cancelled the registration of auditors and entered into enforceable undertakings with certain individuals, in which the individuals undertook never to reapply for registration or act as an auditor.[95] ASIC also referred four confidential matters to the Companies, Auditors and Liquidators Disciplinary Board, which has the power to cancel or suspend the registration of a liquidator or auditor.[96] In addition, ASIC provided information to professional accounting bodies to enable them to take appropriate disciplinary action against members.[97]

In 2012, ASIC was given additional enforcement powers through the Corporations Legislation Amendment (Audit Enhancement) Act. ASIC may make use of a name and shame strategy. It may publish audit deficiency reports if the regulator considers an audit firm has not taken appropriate remedial action to remedy a failure to comply with relevant auditing standards, codes of conduct or requirements under the Corporations Act. In some instances, ASIC has the power to communicate its concerns directly with the affected audit client.

The Audit Enhancement Act also requires audit firms that audit 10 or more significant entities (defined as listed companies, listed registered schemes, authorized deposit-taking institutions and insurance companies) to publish an annual transparency report on their websites outlining the firm's legal structure, partner remuneration, internal procedures and fees. The report must also be lodged with ASIC. Audit transparency reports are required by ASIC because of the important role played by auditors as gatekeepers who contribute to a fair and efficient market in Australia. ASIC is of the view that transparency reports inform market participants about audit firms and audit quality.[98] The requirement for these reports fits the aim of ASIC to promote audit quality through a range of mechanisms, including reporting on current levels of audit quality, identifying areas for improvement and working with firms to achieve improvements.[99]

International activities

ASIC works with international regulators to encourage large global audit firms to improve audit quality. In 2013, ASIC worked with the International Auditing and Assurance Standards Board, International Forum of Independent Audit Regulators and IOSCO to promote

93 ASIC, 2012, Auditor's obligations: Reporting to ASIC, Regulatory Guide 34, available at http://download.asic.gov.au/media/1238083/rg34-published-31-may-2013.pdf (accessed 4 January 2016).

94 ASIC, 2013.

95 In 2012–2013, ASIC disqualified certain individuals from acting as liquidators and entered into enforceable undertakings with them.

96 ASIC, 2013.

97 FRC, 2013.

98 ASIC, 2013, Audit transparency reports, Information Sheet 184, available at http://download.asic.gov.au/media/1338902/info184-published-19-August-2013.pdf (accessed 4 January 2016).

99 Audit firm transparency reports are available on the firms' websites. For example, see the reports of PricewaterhouseCoopers Australia, available at http://www.pwc.com.au/publications/transparency.html, and KPMG, available at http://www.kpmg.com/au/en/issuesandinsights/articlespublications/pages/transparency-report.aspx.

improvements in international auditing and auditor independence standards.[100] Meetings with other regulators provide mechanisms to share information between members of the International Forum of Independent Audit Regulators, for example about the audit inspection process.

ASIC has specific agreements with other regulators regarding audit firm oversight. It has arrangements with PCAOB to conduct joint audit inspections in relation to the requirements of the Sarbanes-Oxley Act. ASIC has entered into arrangements with CPAB for audit inspections that may involve joint inspections. Finally, ASIC also has arrangements with audit regulators in the European Union whereby they may rely on ASIC inspection reports for audit firms that audit Australian companies listed in Europe or Australian subsidiaries of European listed companies.[101]

2. Financial Reporting Council

FRC is not a standard setting or enforcement body, but has influence over other bodies with a standard setting and enforcement role. Its functions are specified in the ASIC Act. FRC is responsible for providing broad oversight of the process for setting accounting and auditing standards and for appointments to both boards. In 2013, FRC carried out a range of activities in relation to the standard setting bodies (AASB, Australian Auditing and Assurance Standards Board and Accounting Professional and Ethical Standards Board), developments in financial reporting in Australia and international developments.[102] FRC has a strategic advice role in relation to audit quality. This means that FRC may advise the Government about the effectiveness of Corporations Act provisions related to audits and the review and disciplinary processes undertaken by the professional bodies.[103] FRC therefore works with other parties to promote audit quality, for example through its audit quality committee.

[100] FRC, 2013.

[101] ASIC, 2014, Audit inspection and surveillance programmes, available at http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/audit-inspection-and-surveillance-programs/ (accessed 1 July 2014). More information about the relationships of ASIC with international regulators is available on the ASIC website.

[102] FRC, 2013.

[103] Ibid. For more information about the role and activities of FRC, see http://www.frc.gov.au.

D. MONITORING COMPLIANCE WITH CODES OF PROFESSIONAL CONDUCT AND OTHER APPLICABLE PROFESSIONAL MEMBERSHIP REQUIREMENTS

Professional accounting bodies have a long history of active involvement in financial reporting in Australia. Currently there are three main professional bodies: CPA Australia; CAANZ; and IPA. They contribute to the work of the standard setting bodies (AASB, Australian Auditing and Assurance Standards Board and Accounting Professional and Ethical Standards Board) whose role is to develop high-quality financial reporting, auditing and ethical standards. The professional bodies are leaders in the education and training of members. This is an important role, as their members are key contributors to the preparation and review of financial reports. Importantly, the professional bodies are active in promoting high professional standards, compliance with accounting and auditing standards and in leading improvements in the quality of financial reporting and auditing.

1. Education and training

The professional bodies are involved in the education and training of their members. The bodies liaise with universities and other education providers and also provide their own training programmes for people seeking membership in the profession. They provide ongoing professional development and training related to legal, accounting, technical, business and ethical issues. They develop materials in their own right and contribute to the development of materials by others. For example, in February 2013, the professional bodies issued a revised version of the Auditor Independence Guide, which provides guidance to members when they are confronted with issues related to auditor independence.[104]

Education and training assists practitioners to comply with the requirements of accounting and auditing standards. Practitioners are also involved in extensive peer review programmes to ensure that high standards

[104] The professional bodies provide details about their education and training programmes on their websites. For example, see http://www.cpaaustralia.com.au/cpa-program, http://www.charteredaccountants.com.au/Training and http://www.publicaccountants.org.au/students.

of audit quality are maintained. For example, one of the four largest firms in Australia is typically involved in several levels of peer review, including a review of audit files by the firm's partners in other offices in various Australian states and also by the network's partners in other countries. Partners have reputational and financial incentives to ensure that their audit files comply with all standards and regulations.

2. Quality review programmes

Australia has a co-regulatory regime regarding the ASIC audit inspection programme. The professional bodies cooperate with ASIC in the implementation of their quality review programmes. In general, the review programmes apply to members who hold a certificate of public practice and are registered company auditors. The programmes aim to assess whether members have implemented appropriate quality control policies and procedures in their accounting practices. Practices are reviewed every three, four or five years, with more frequent reviews for practices showing non-compliance.

The CPA Australia quality review programme for the year ended 30 June 2013 concluded the following: 27.5 per cent of accept reports showed no departures from professional standards; 50.4 per cent of assurance reports showed minor departures; and 22.1 per cent of follow-up review reports showed a breach of an audit standard. Such breaches led to a follow-up review in the next year. If breaches are not addressed, the matter is addressed through disciplinary action related to professional conduct.[105]

In 2012–2013, chartered accountants in Australia (Institute of Chartered Accountants in Australia, now part of CAANZ) reviewed the audit files of listed entities and entities regulated by the Corporations Act (33 per cent), self-managed superannuation funds (39 per cent) and other entities (28 per cent).[106] The programme reported that 80 per cent of practices met all the professional standards and regulator's requirements (or showed a level of non-compliance that was not significant). Practices with significant non-compliance issues were required to develop an action plan outlining how they would address the issues and the practices were reviewed again within the year. If a firm's response to the review is inadequate, the practice may be referred to the CAANZ professional conduct team.[107]

Chartered accountants publicize the activities and outcomes of a quality review programme through an annual public report.[108] The report serves to outline the role of the Institute of Chartered Accountants in Australia in promoting compliance with auditing standards and other relevant regulations and in improving audit quality. The report has both compliance reporting and educative elements, as follows:

(a) First, the report outlines the procedures of the quality review programme in order that practitioners know the focus, timing and scope of reviews. For example, the report explains the types of reviews that are conducted and shows the entities that are subject to reviews. The way a review is carried out and what actions follow from the review are also explained.

(b) Second, a summary of the results of the review programme is provided, adding to its transparency and usefulness. The report highlights common areas of non-compliance, for example with Australian Professional and Ethical Standard 320 and Auditing Standard on Quality Control 1, and also with specific auditing and independence standards.[109] Data is presented in aggregate form and individual practices are not identified. The information informs regulators, practitioners and other interested parties about the current state of audit practice compliance.

(c) Third, the report also provides data from reviews from prior years, thereby allowing practitioners and others to see how practices may be improving over time.

[105] FRC, 2013.

[106] The reviews are carried out by chartered accountants who work, or have worked, in public practice and who are selected based on their reputation and professional practice experience. For more information about reviews by CPA Australia, see http://www.cpaaustralia.com.au/professional-resources/public-practice/quality-review.

[107] FRC, 2013.

[108] CAANZ, 2011, Annual report on the quality review programme, available at http://www.charteredaccountants.com.au/Industry-Topics/Quality-review/Recent-headlines/Recent-headlines/Quality-review-annual-report-2011.aspx (accessed 1 July 2014).

[109] The objective of audit firm reviews is to assess whether a practice has implemented an appropriate system of quality control as set out in Australian Professional and Ethical Standard 320: Quality control for firms and Auditing Standard on Quality Control 1: Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Service Engagements (CAANZ, 2011).

(d) Fourth, the report outlines focus areas for the following year's programme, thus signalling areas where the quality review committee believes there are weaknesses in practice. The report thus aims to help educate practitioners and alert them to areas in which they may focus their efforts to improve their practices. Practitioners have provided positive feedback about the review process. They consider that reviews contribute to upholding professional standards, identifying breaches of standards and quality control procedures in their practices and providing a useful check of whether their practices are up to date.[110]

3. Disciplinary actions

To ensure that all members uphold the applicable standards and codes of professional conduct, the professional bodies have formal processes that enable complaints about members to be heard and evaluated. Where appropriate, disciplinary action may be taken. Some disciplinary actions undertaken by the professional bodies are as follows: forfeiture of membership; withdrawal of the right to use the designation; suspension of membership for a specific period; withdrawal of the right to engage in public practice; imposition of a fine; reprimand or admonishment; and requirement that a member undertake additional continuing professional education or order a quality review of the member's practice.[111]

4. International activities

Each of the professional bodies is involved in a range of international activities. Activities arise from having members who work in other countries and from alliances and liaisons with accounting bodies in other countries.[112] For example, the Institute of Chartered Accountants in Australia is part of the Global Accounting Alliance, an organization linking chartered accounting firms. In 2014, the Institute joined chartered accountants in New Zealand to form a regional group to better meet the objectives of both groups.

The professional bodies are members of IFAC. CAANZ and CPA Australia hold seats on the IFAC Council. Membership allows the Australian bodies to participate in international developments and also imposes various obligations related to professional practice and behaviour.[113] The professional bodies interact with the international community formally. For example, CPA Australia members are representatives on several of the boards and committees of IFAC.[114] They also interact in a range of other ways, for example CAANZ has been involved in working with other entities in seven countries in Asia to develop education, training and leadership programmes.[115] CAANZ has also participated in meetings and workshops to assist government entities and professional bodies in other countries to develop their regulatory frameworks.[116]

E. CONCLUSION

This case study describes the framework in Australia for financial reporting and outlines the roles and activities of the major parties in this framework that are responsible for MCE. A number of features emerge from the study, which may be of interest

[110] CAANZ, 2011.

[111] CAANZ, 2013, Disciplinary policy paper, available at http://www.charteredaccountants.com.au/The-Institute/Member-complaints-and-discipline/Disciplinary-procedure-and-policy/Disciplinary-policy-paper (accessed 1 September 2014); IPA, 2014, Disciplinary process, available at http://www.publicaccountants.org.au/media/115787/IPA-Disciplinary-Process.pdf (accessed 15 August 2014). Information about expectations of member behaviour and disciplinary procedures against members are publicized on the websites of the professional bodies. For example, see http://www.cpaaustralia.com.au/about-us/member-conduct-and-discipline and http://www.publicaccountants.org.au/about-us/complaint-investigation-member-disciplinary-action.

[112] CPA Australia has around 150,000 members working in 121 countries (CPA Australia, 2013, Driving a competitive future: CPA Australia 2013 integrated report, available at http://www.cpaaustralia.com.au/~/media/corporate/allfiles/document/about/annual-report-2013.pdf?la=en (accessed 4 January 2016)).

[113] IFAC has issued statements of member obligations, which are the basis of the IFAC member body compliance programme and designed to assist member organizations to serve the public interest by supporting the adoption and implementation of international standards and maintaining quality assurance review systems and investigation and discipline mechanisms. For more information, see http://www.ifac.org/about-ifac/membership.

[114] CPA Australia, 2013.

[115] For more information, see http://www.charteredaccountants.com.au/The-Institute/The-Institute-worldwide/The-Institute-in-Asia.aspx.

[116] For more information, see http://www.charteredaccountants.com.au/The-Institute/The-Institute-worldwide/The-Institute-in-Asia/Latest-updates/Latest-updates/ICAA-participates-in-workshops-in-Indonesia-and-Dubai.aspx.

to other regulators and policymakers involved in the development and improvement of national frameworks for financial reporting and auditing.

First, the framework reflects a collaborative approach, with the involvement of multiple entities working in cooperation with each other. The setting of legislation, the implementation and enforcement of law and the monitoring of practice is under the jurisdiction of specific entities, but many parties with appropriate expertise have input into the process. For example, FRC consults widely with stakeholders about the operations of the framework and provides input to the Government on policy issues, such as how legislation is implemented, its effectiveness and the nature of changes required, if any. This process may be observed in relation to audit quality in recent years. The parties involved in assessing and improving audit quality include ASIC, FRC, the Government, the professional accounting bodies, standard setting boards and auditors and company directors. This study illustrates a process of dialogue, engagement with stakeholders and working together to achieve common goals.

Nevertheless, the process is not without friction. As a regulator, ASIC forms views about how compliance with accounting standards is to be achieved. It may be that companies and auditors take a different view to ASIC about how standards should be interpreted and applied. Similarly, in relation to audit procedures and the application of auditing standards, ASIC inspectors may take a different view to auditors. The extent to which the regulator, in this case ASIC, becomes the final arbiter of how principles-based accounting and auditing standards are to be applied (the strength of the regulator's stance) may be a contentious issue in practice.

The position taken by the regulator reflects strategic decisions about the extent to which the regulator seeks to exercise its power to enforce accounting and auditing standards. In Australia, ASIC is a body set up and funded by the Government and its level and direction of activity reflect the objectives and initiatives of the Government of the day. Parties being regulated may disagree with the regulator's decisions or how the process is carried out and, in Australia, they are free to express these views. For example, there has been debate about whether regulatory changes meet their objectives and whether the costs of changes exceed their benefits.[117] ASIC also receives and responds to criticism.[118]

Second, this study points to a process of continuous improvement. The business environment has experienced massive change over the last 30 years and the parties in the framework have developed and evolved. The Australian Government, similar to Governments in many other countries, has sought to provide an environment that stimulates and enhances economic growth and achieves optimal regulation. Regulation may be viewed as efficient when it is enough to provide support and protection when required but not so much as to hinder the operations of markets and businesses.[119] Whether the regulatory changes in Australia over the past decade, particularly in relation to auditing standards, practices and oversight, have been effective is still a matter of debate.[120] Nevertheless, an enquiry following the financial crisis in 2008 reported that the auditing framework in Australia was robust and stable and represented international best practices.[121]

The framework for audit and assurance provides examples of changes over many years as the Government has intervened in response to economic events, provided ongoing monitoring and evaluation and introduced further improvements to the framework. The establishment of the twin peaks strategy, of prudential regulation by APRA of financial institutions and the regulation of other entities by

[117] K Houghton, M Kend and C Jubb, 2013; A Hecimovic, N Martinov-Bennie and P Roebuck, 2009, The force of law: Australian auditing standards and their impact on the auditing profession, *Australian Accounting Review*, 48(19):1–10.

[118] ASIC, 2013, Stakeholder survey, available at http://download.asic.gov.au/media/1311529/ASIC-stakeholder-survey-2013-1.pdf (accessed 4 January 2016). Feedback from the stakeholder survey in 2013 stated that ASIC was not acting quickly enough to investigate breaches of the law, not clearly communicating about its activities and not doing enough to reduce the bureaucracy associated with compliance. ASIC subsequently responded to these criticisms. For more information about the survey in 2013 and surveys in previous years, see http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC+stakeholder+survey?openDocument.

[119] P Brown and A Tarca, 2007, Achieving high-quality, comparable financial reporting: A review of independent enforcement bodies in Australia and the United Kingdom, *Abacus*, 43(4):438–473.

[120] K Houghton, M Kend and C Jubb, 2013.

[121] Commonwealth of Australia, 2010, Audit quality in Australia: A strategic review, available at http://archive.treasury.gov.au/documents/1745/PDF/Audit_Quality_in_Australia.pdf (accessed 4 January 2016).

ASIC, has been identified as one of the strengths of the Australian framework and an explanation for the sound performance of Australian banks during the financial crisis in 2008.[122] This approach to regulation was developed through the Wallis financial system inquiry and enhanced following the investigation into the collapse of the listed company HIH Insurance Limited, illustrating the process of learning from past events.

Third, a positive and negative reinforcement approach to MCE may be observed. The entities involved use many methods to encourage desired compliance behaviour, for example through education. ASIC, ASX, FRC and the professional bodies are active in issuing guidance on best practices and providing educational materials and training that assist participants in learning what is expected in practice and how to work towards achieving it.

Importantly, the framework provides regulators with the vital tools to take action to ensure regulations are applied when they should be. The framework is clear about which entities are responsible for taking enforcement actions and what remedies are open to them. Regulators make use of the legal system and the powers given to them to levy fines and penalties and to take matters to court. Being seen to be an active regulator that will take punitive action is an important part of maintaining credibility and effectiveness as an enforcement body. However, court actions are time consuming and expensive and outcomes may be uncertain. To achieve efficiencies, regulators employ other measures that are less costly, such as the use by ASIC of enforceable undertakings.

Fourth, all of the entities in the framework are involved at various levels in international collaborative activities. Regulators see participation in international activities and organizations as essential for effective domestic regulation, given globally connected financial markets.[123] The present environment features international business activities in which companies, audit firms and professional accounting bodies operate across borders. Accordingly, it is appropriate and necessary that regulators in Australia work in conjunction with regulators in other countries.

[122] C Bowen, 2009, Interview with Consumer News and Business Channel Squawk Box Asia, available at http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=transcripts/2010/005.htm&pageID=004&min=ceba&Year=&DocType=2 (accessed 1 July 2014).

[123] J Cooper, 2006.

There is a strong pattern of learning from others who experience the same or similar problems and of sharing knowledge and getting the most out of available resources. All entities operate at various times with limited resources. Maximizing value from available resources is a high priority. International collaborations may focus on a specific issue, such as securitization following the financial crisis in 2008. ASIC was the co-chair of the IOSCO Task Force on Unregulated Financial Markets and Products, which made recommendations to improve confidence in securitization markets.[124] Through its work with other regulators following the financial crisis, ASIC was able to ensure that its activities were more effective.

International collaborations may be for a specific meeting or project or they may be ongoing. For example, ASIC joins with other securities market regulators via IOSCO to exchange information about the application of IFRS by listed companies in their jurisdictions. Such activities provide a way to leverage from the experiences of others. The high level of international collaboration has seen the spread of new practices around the world. For example, many countries now have bodies responsible for the oversight of public company auditors, following the events in the United States in 2001–2002 concerning Enron and Arthur Andersen. Through the International Forum of Independent Audit Regulators, national bodies can share information about audit firm inspections, which have become an important tool of regulators used throughout the world. Given that companies and audit firms operate internationally, international cooperation by regulators regarding audit inspections is also beneficial to ensure that regulation is cost effective and that regulatory efforts are not duplicated in various jurisdictions for audit firms with client firms that operate internationally.

Fifth, this study illustrates how the cooperative approach used in Australia involves many parties and brings resources to the monitoring and compliance process from a number of sources. For example, the involvement of the stock exchange and the professional accounting bodies brings financial and practical contributions for MCE from corporations and individual practitioners. This approach supplements

[124] G Medcraft, 2011, speech to APRA leadership team, available at http://asic.gov.au/about-asic/media-centre/speeches/speech-to-the-australian-prudential-regulation-authority-leadership-team/ (accessed 4 January 2016).

public funding for enforcement and involves other entities in matters that are fundamentally important to their interests.

In summary, there are many features of MCE for financial reporting that may be of interest to practitioners and regulators in other countries. In Australia, the financial reporting framework is based in a large part on law, which requires implementation and administration. The promulgation of sound laws and their effective implementation requires experienced and skilled people as well as a structure for administration and enforcement activities.[125] How MCE is carried out reflects the extent to which a Government prioritizes resources for the task of development, implementation and enforcement of regulatory requirements.

Regulation is a political process and effective regulation reflects not only the strategy of Government but also consultation with stakeholders to ensure that any proposed regulation will achieve its intended outcomes. The Australian example shows a process of consultation where many parties work cooperatively with each other. A specified structure that guides working relationships between entities is useful (such as a memorandum of understanding between parties). Mechanisms for oversight (such as through FRC) and formal and informal processes for consultation between parties also assist collaboration and processes for exchanging information.

A striking feature of the Australian setting is the level of cooperation between government agencies and private sector bodies to achieve enforcement outcomes. For example, ASIC is involved in enforcing corporations law related to auditors and audit quality. However ASIC works with the professional accounting bodies to ensure that each entity focuses on a different group of auditors and audit firms in the audit inspection and professional firm review process. Another example is the development of best practice guidelines for corporate governance that involves the stock exchange and private sector bodies.

Another feature of the Australian setting is the international engagement of the leading entities. Australian bodies interact with their international counterparts through meetings, special projects and staff exchanges. For many years, Australian individuals have taken roles in international organizations and brought this expertise back to the operations of Australian entities. In addition, staff members contribute their experience from Australian operations to developing agencies in other countries.

This case study shows a process of development of regulatory requirements and institutions as events unfold. At times the approach adopted may not achieve its goals and changes are made, for example the modifications to the operations and activities of APRA following the review of the collapse of HIH Insurance Limited. The role of APRA was examined again following the financial crisis in 2008. In this instance, continuing the twin peaks regulatory approach was recommended. Each country must determine the regulatory approach best suited to its situation. However, events during the 2008 crisis confirmed that this approach is effective in Australia.

Continued economic development is important to Australia. The key role of capital markets as providers of capital is well recognized. Therefore, promoting high-quality financial reporting and auditing to support the informational efficiency of capital markets will remain a priority. The extent of public resources devoted to MCE is a political issue and a decision of the Government. History shows that expenditure on enforcement varies with economic conditions and events, as well as political opinions. For example, events such as the Enron affair and the financial crisis led to short and long-term changes in the activities of regulators. The close interaction between economic events, politics, Governments and regulators may be expected to continue in the future.

[125] P Brown and A Tarca, 2007.

APPENDIX II.1 PARTICIPANTS IN THE AUSTRALIAN FINANCIAL REPORTING FRAMEWORK

The following tables provide summaries of the roles of rule-makers, financial statement preparers and rule enforcers, as well as the relevant legislation, regulations, standards and guidance.[126]

Table 1 Australian financial reporting framework: Rule-makers

	Role	Legislation, regulation, standard and guidance
Government: Commonwealth of Australia	Legislate financial reporting requirements to promote capital market development and efficiency and to enhance investor protection	Corporations Act ASIC Act APRA Act Australian Charities and Not-for-profits Commission Act Financial Management and Accountability Act Commonwealth Authorities and Companies Act
Accounting standard setting body: AASB	Provide high-quality accounting standards to be used in financial reporting by private and public sector and not-for-profit entities	Australian accounting standards issued by AASB, based on IFRS
Auditing standard setting body: Australian Auditing and Assurance Standards Board	Provide high-quality auditing standards to be used by external auditors when auditing financial statements	Australian auditing standards issued by Australian Auditing and Assurance Standards Board, based on International Standards on Auditing issued by IFAC
Stock exchange: ASX	Regulate financial reporting to promote efficient and equitable financial markets	ASX Corporate Governance Principles and Recommendations, third edition, 2014 (may influence financial reporting practices)
Professional accounting bodies: CPA Australia CAANZ IPA	Provide regulations and guidance in relation to member behaviour that will influence financial reporting and auditing practice	Professional practice standards issued by Accounting Professional and Ethical Standards Board

Table 2 Australian financial reporting framework: Financial statement preparers

	Role	Legislation, regulation, standard and guidance
Directors	Prepare company financial reports for presentation to shareholders, regulatory bodies and other interested parties	Corporations Act ASX Listing Rules ASX Corporate Governance Principles and Recommendations
Executives and employees	Prepare financial statements for directors	

[126] For more information, see P Brown and A Tarca, 2005.

Table 3 Australian financial reporting framework: Rule enforcers

	Role	Legislation, regulation, standard and guidance
Auditors	Provide assurance to shareholders in relation to information provided in financial statements	Corporations Act AASB Australian Auditing and Assurance Standards Board
Professional accounting bodies: CPA Australia CAANZ IPA	Require members to comply with standards related to conduct, competency and independence; conduct quality review programmes	Corporations Act AASB Australian Auditing and Assurance Standards Board Australian Professional and Ethical Standard 320: Quality Control for Firms Auditing Standard on Quality Control 1: Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Service Engagements
FRC	Oversight of AASB and Australian Auditing and Assurance Standards Board Monitor and assess independence of auditors	Corporations Act
ASIC	Promote compliance with financial reporting and auditing requirements; promote auditing independence and quality of external auditing	Corporations Act ASIC Act
APRA	Supervise banks, credit unions, building societies, insurance companies and superannuation funds	APRA Act

APPENDIX II.2 SUMMARY STATISTICS OF AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION OPERATIONS, 2010–2013

The following table presents a summary of Australian Securities and Investments Commission operations in 2010–2013.

Table Summary statistics of Australian Securities and Investments Commission operations, 2010–2013[127]

	2013	2012	2011	2010
	Year ended 30 June			
Revenue and expenditure (Millions of Australian dollars)				
Government appropriation (revenue received from the Government, including appropriations and other revenue)	367	339	345	381
Funds raised for the Government	717	664	622	582
Operating expenses	411	384	385	387
Staff (total)	1 844	1 738	1 893	1 932
Surveillance: Accounting and auditors (staff members whose tasks include financial reporting and auditing surveillance as well as other work)	38	40	33	Not stated
Corporations (including disclosure)	49	54	58	Not stated
Companies	2 012 241	1 921 545	1 839 772	1 768 526
Financial reports reviewed	280	450	500	480
Registered company auditors	4 852	4 985	5 114	5 207
Audit firm inspections	16	Not stated	21	19
Number of audit files	107	Not stated	131	Not stated

[127] The information in the table is drawn from the annual reports of ASIC in 2010–2013, available at http://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/.

CHAPTER III. CASE STUDY: BELGIUM

A. INTRODUCTION

This case study presents an overview of Belgium's MCE system in relation to financial and non-financial reporting, audit oversight and regulation of the accountancy profession.[128] These topics are discussed in sections B to D, and section E presents a summary and conclusion.

The GDP of Belgium amounted to $508.12 billion in 2013.[129] The GDP value of Belgium represents 0.82 per cent of the world economy and the GDP averaged $184.62 billion in 1960–2013, reaching an all-time high of $513.32 billion in 2011 and a record low of $11.70 billion in 1960. Belgium hosts many international organizations and foreign enterprises (including subsidiaries and branches). Belgian small and medium-sized enterprises develop business relations with foreign contractors (including suppliers and clients). Belgium has 16 high-level universities, seven of which are listed in the Academic Ranking of World Universities. Dutch, French and German are the official languages. English is also broadly spoken, due to the European and international organizations and enterprises active in Belgium.

Belgian companies are required to file their financial statements with the department of Central Balance Sheet Office of the National Bank of Belgium. The financial statements are accessible by the public free of charge on the Bank's website. The financial information (including annual and interim) of listed companies is made available on their respective websites and is also available on the enforcer's website. Listed companies are also required to make it possible for interested parties to subscribe free of charge to an electronic mailing system that sends all financial information via e-mail concurrently with publication on the websites.

The main regulated market in Belgium is Euronext Brussels. Large entities (companies and not-for-profit associations) are audited by registered auditors. Approximately 25,000 companies in Belgium are required to issue an audit report. As at 31 December 2012, 184 of these were listed companies, of which 177 were Belgian companies and seven were foreign. There are 44 credit institutions and 88 insurance companies governed by Belgian law. There are three professional accountancy organizations in Belgium, as follows (as at 31 December 2013):

(a) Institute of Registered Auditors: 1,055 registered auditors and 512 audit firms employing 3,500 persons

(b) Institute of Accountants and Tax Consultants: 6,498 chartered accountants (natural persons), including 4,354 chartered accountants in public practice and 2,144 accountants in business and 3,295 accounting firms

(c) Institute of Accounting Professionals and Tax Experts: 4,974 bookkeepers and 3,560 bookkeeper firms

The Financial Services and Markets Authority liaises with ESMA and is a member of IOSCO. The National Bank of Belgium (central bank) has been the banking and insurance supervisor since 2011. The Ministry of Economy is also a competent authority for accounting and auditing, and is part of the auditor oversight system. The High Council for Economic Professions, whose members are appointed by the Government, is composed of representatives of socioeconomic partners, and provides opinions on economic professions, which are binding if they relate to standards applicable to more than one profession. The Council also coordinates the activities of the oversight system on statutory auditors, as required by Directive 2006/43/EC of the European Parliament and of the Council, and liaises among others with the

[128] This case study was prepared for UNCTAD by David Szafran, Associate Lawyer, Law Square, Belgium, and Chair, thirtieth session of ISAR.

[129] Trading Economics database, available at http://www.tradingeconomics.com/belgium/gdp (based on data provided by the World Bank Group).

Chamber of Disciplinary Transfer and Indictment, which is a member of the International Forum of Independent Audit Regulators at the international level and of the European Group of Auditors' Oversight Bodies at the European level.[130]

The Accounting Standards Board is the competent commission for accounting standards.

As indicated above, the economic professions are organized under the following three professional bodies: Institute of Registered Auditors; Institute of Accountants and Tax Consultants; and Institute of Accounting Professionals and Tax Experts. However, following the implementation of Directive 2006/43/EC in 2007, ultimate responsibility for auditor oversight rests mainly with the following:

(a) High Council for Economic Professions: Composed of socioeconomic representatives. Responsible for approving standards on auditing proposed by the Institute of Registered Auditors and following up on anticipated cessations of statutory audit engagements

(b) Ministry of Economy: Responsible for the approval of standards on auditing proposed by the Institute of Registered Auditors

(c) Chamber of Disciplinary Transfer and Indictment: Responsible for quality assurance and surveillance, including disciplinary investigations

As shown in the figure, the public oversight system in Belgium also includes the Attorney General (responsible for the public register), disciplinary chambers and Advisory and Supervisory Committee on Auditor Independence. The term of the Committee's board members ended in 2008.

Applicable accounting, auditing and other corporate reporting standards

Under European regulations, IFRS are compulsory for the consolidated accounts of listed entities in Belgium, as well as for the consolidated financial statements of credit institutions and insurance companies. Other Belgian companies may opt to prepare their consolidated financial statements in accordance with IFRS. For other financial statements, Belgian accounting standards are applicable. International Standards on Auditing have been mandatory in Belgium for statutory audits of public interest entities (listed companies, credit institutions and insurance companies) since 2012, and for all statutory audits of financial statements, in addition to public interest entities, since 2014.

The Code on Corporate Governance, 2009, applies to listed companies on a comply or explain basis.[131] In compliance with Directive 2006/46/EC, the Belgian Companies Code requires listed companies to disclose a corporate governance statement in an annual report that is part of the financial statements filed with the Central Balance Sheet Office of the National Bank of Belgium and published on its website. The Code on Corporate Governance applies on a voluntary basis to non-listed companies (recommendations for which are in Code Buysse II).[132]

B. MONITORING COMPLIANCE WITH THE FINANCIAL REPORTING FRAMEWORK AND STANDARDS AND APPLICABLE ENFORCEMENT MECHANISMS

1. Regulatory basis

Listed companies, credit institutions and insurance companies are subject to a compulsory statutory audit by a registered auditor, under the Companies Code (for listed companies) and under the relevant legislation (for credit institutions and insurance companies).

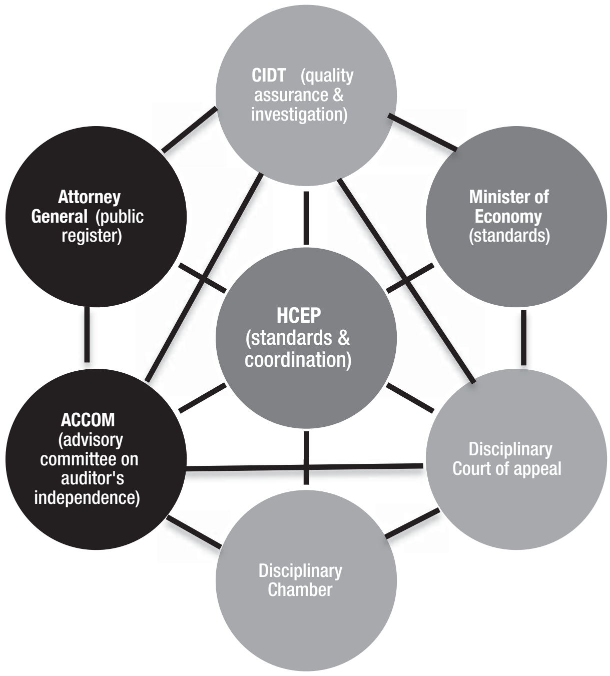
Under the Companies Code, large companies, even if they are not a public interest entity, are also subject to a compulsory statutory audit. A small company is a company that does not exceed two of the following limits for two consecutive financial years (on a consolidated basis): net turnover of €7.3 million; balance sheet total of €3.65 million; and employee number of 50 (average annual workforce). If the above limits are met (or exceeded) in the way described above, or if the average annual workforce exceeds

[130] For more information, see the list of International Forum of Independent Audit Regulators member jurisdictions and profiles, available at http://www.ifiar.org/Members.aspx, and the European Group of Auditors' Oversight Bodies documentation, available at http://ec.europa.eu/internal_market/auditing/egaob/.

[131] For more information, see http://www.corporategovernancecommittee.be/en/about-2009-code/2009-belgian-code-corporate-governance.

[132] For more information, see http://www.codebuysse.com/en/default.aspx.

Figure Public oversight system in Belgium



100 employees, companies are considered large, in accordance with article 15 of the Companies Code. Large not-for-profit associations are also subject to compulsory statutory audits. Statutory auditor reports assess the compliance of the audited financial statements with the applicable financial reporting framework (such as IFRS and the Belgian Generally Accepted Accounting Principles (GAAPs)). Public interest entities are subject to MCE mechanisms of the Financial Services and Markets Authority and National Bank of Belgium, under national and European legislation.

The standard on auditing related to the cooperation of registered auditors with the banking and insurance supervisor, dated 8 October 2010, has been adopted by the oversight authorities (Ministry of Economy and High Council for Economic Professions).[133] The Institute of Registered Auditors proposed the standard after consultation with banking and insurance supervisors and after public consultation on an exposure draft.

[133] In 2010, the banking and insurance supervisor was the Banking, Finance and Insurance Commission. This responsibility was transferred to the National Bank of Belgium on 1 April 2011.

2. Institutional setting

Financial Services and Markets Authority

The Financial Services and Markets Authority was created in April 2011 and partly succeeded the Banking, Finance and Insurance Commission. The Authority is responsible for the supervision of information disseminated by companies, products, compliance with the rules of conduct, financial services providers and intermediaries and supplementary pensions and financial education. The Authority is mandated to monitor compliance by listed companies with the financial reporting framework and standards, and liaises with ESMA in this regard.

The National Bank of Belgium has supervisory responsibility for credit institutions and insurance companies. As of 4 November 2014, the European Central Bank has direct supervisory responsibility for European systemic credit institutions (including several Belgian credit institutions) and indirect supervisory responsibility for other European credit institutions, under the Single Supervisory Mechanism of the European Central Bank.

As at 31 December 2013, the Financial Services and Markets Authority had 282 full-time or equivalent employees. The department for the supervision of listed companies and surveillance of financial markets reports to the chair of the management committee of the Authority and the department of enforcement reports to the Secretary-General of the Authority. The annual report of the Authority in 2013 addressed the following four domains in particular: inspections; product supervision; financial education; and extension of competencies. Information related to notifications of takeover bids and squeeze-out bids is published on the Authority's website. The Authority also publishes warnings related to failures to comply with information requirements, suspensions of trading in financial instruments and illegal public solicitations of funds, as well as warnings from foreign authorities who are members of ESMA or IOSCO.

Enforcement decisions by the Financial Services and Markets Authority related to IFRS are not published as such, but are included, on an anonymous basis, in the database coordinated by the European Enforcers Coordination Sessions. Extracts from the database of enforcement decisions are published on a regular basis and available on the ESMA website. The Authority is responsible for supervising financial markets and listed companies, authorizing and supervising certain categories of financial institutions, overseeing compliance by financial intermediaries with codes of conduct and supervising the marketing of investment products to the general public, as well as for social supervision of supplementary pensions.

National Bank of Belgium

The Sanctions Commission of the National Bank may impose administrative fines on institutions under its oversight. The decisions are published and the name of the institution is disclosed, unless such disclosure might impair financial stability or cause disproportionate prejudice towards the institution or persons involved.[134] As at 31 December 2013, the National Bank had 2,071 full-time equivalent employees.

C. MONITORING COMPLIANCE WITH THE AUDIT AND ASSURANCE FRAMEWORK

1. Regulatory basis

The law dated 22 July 1953, as amended on 30 April 2007, implements Directive 2006/43/EC. Under this law, the Institute of Registered Auditors, under the ultimate responsibility of the relevant auditor oversight body (Chamber of Disciplinary Transfer and Indictment), monitors the compliance of statutory audit engagements with standards on auditing and ethical rules, through quality assurance reviews, surveillance, investigations and disciplinary procedures.

Quality assurance reviews are conducted every three years of the auditors of public interest entities and every six years of other auditors. Reviews are based on publicly available quality assurance guidelines, established on the basis of the legal requirements applicable to auditors, in particular on the application of standards on auditing and ethical rules. Each year, the oversight authority establishes, following a proposal by the Institute of Registered Auditors, the list of auditors subject to quality assurance reviews and establishes a list of inspectors who will be in charge of performing the reviews. Inspectors of auditors of public interest entities are former auditors who no longer practice but have sufficient relevant experience, while inspectors of auditors of non-public interest entities are registered auditors. The conclusions of the reviews, proposed by the Institute of Registered Auditors or directly by the oversight authority, are decided by the latter, and may involve the issuance of one of the following:

(a) Positive conclusion (implying a further review after the usual three or six years); in some circumstances, this conclusion may be accompanied by a comment letter

(b) Recommendations (implying a further review after the usual three or six years)

(c) Recommendations, to be followed by a further review within one year (instead of after the usual three or six years)

[134] For example in 2013, the National Bank of Belgium proposed to a Belgian credit institution to close a case against a payment of €250,000, due to the fact that the institution had cooperated in the investigation and taken appropriate measures to comply with the anti-money laundering regulation in the context of cash deposits by clients. Although this case is not directly related to corporate reporting, it shows that in due process a proposal for a transaction may be based on a proposal by an auditor (acting as prosecutor) of the National Bank of Belgium.

(d) Filing of a procedure before the disciplinary authorities (in some circumstances and where appropriate), possibly leading to disciplinary sanctions

The surveillance procedure consists of analysing the work performed by registered auditors through a request for information (that may lead to closure of a case or, where appropriate, a formal investigation) or a formal investigation. Surveillance may be initiated by the Institute of Registered Auditors (for example based on press articles or in the event of bankruptcy of an audited entity) or by the oversight authority (on its own initiative or for example based on a complaint by a client or a stakeholder), including the Ministry of Economy, Attorney General, Chamber of Disciplinary Transfer and Indictment and High Council for Economic Professions.

The oversight authority decides on the conclusion of a formal investigation (following a proposal by the Institute of Registered Auditors, unless the investigation is performed directly by the oversight authority), deciding either to close the investigation (without proceeding before a disciplinary authority) or to file a procedure before a disciplinary authority (possibly leading to disciplinary sanctions). Based on the file introduced by the oversight authority (after an investigation or a quality assurance review), the disciplinary authority consults the auditor before making a decision. An appeal against a decision by a disciplinary authority in the first instance may be filed with the disciplinary court of appeal. An appeal against a decision by the disciplinary court of appeal may be filed with the Supreme Court (the highest judicial authority in Belgium).

The Institute of Accountants and Tax Consultants has also initiated quality reviews of engagements performed by chartered accountants and tax advisers. Members of the Institute are not entitled to perform statutory audit engagements under Directive 2006/43/EC, but are entitled (as are registered auditors) to perform specific assurance engagements, for example in the event of a merger or dissolution of a commercial company.

Statutory audits of third-country entities listed in Belgium

Seven foreign audit firms located in non-European Union third countries are also registered in Belgium due to the fact that they perform statutory audits of entities located in non-European Union third countries listed on the stock exchange in Belgium. This is in accordance with article 45 of Directive 2006/43/EC as implemented in Belgium under the law dated 22 July 1953, as amended on 30 April 2007, and the Royal Decree dated 3 September 2010. Registration is required according to article 45 of Directive 2006/43/EC if a third-country audit entity provides an audit report concerning the annual or consolidated accounts of a relevant audit client. Article 2(4) of the Directive defines a third-country audit entity as an entity, regardless of its legal form, which carries out audits of the annual or consolidated accounts of a company incorporated in a third country.

The members of the European Union are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom. The members of the European Economic Area that are not also members of the European Union are Iceland, Liechtenstein and Norway. Third-country auditors may register in Belgium if their home country is one of the third countries to which the European Commission has granted a transitional period under Commission Decision 2008/627/EC and Commission Decision 2011/30/EU, amended by Commission Implementing Decision 2013/288/EU of 13 June 2013, in accordance with article 46(2) of Directive 2006/43/EC. These third countries are as follows:

(a) For financial years starting during the period from 29 June 2008 to 1 July 2010: Argentina, Australia, Bahamas, Brazil, Canada, Chile, China, Croatia, India, Indonesia, Israel, Japan, Kazakhstan, Malaysia, Mauritius, Mexico, Morocco, New Zealand, Pakistan, Republic of Korea, Russian Federation, Singapore, South Africa, Switzerland, Thailand, Turkey, Ukraine, United Arab Emirates, United States, Bermuda, Cayman Islands, Guernsey, Hong Kong (China), Isle of Man, Jersey and Taiwan Province of China

(b) For financial years starting during the period from 2 July 2010 to 31 July 2012, extended until 31 July 2013: Bermuda, Egypt, Mauritius, New Zealand, Russian Federation, Turkey and Cayman Islands

(c) For financial years starting during the period from 2 July 2010 to 31 July 2012, without an extension: India, Israel and Hong Kong (China)

The home country is ordinarily the country where the third-country audit entity and the audit client are incorporated or have their main offices. In the event that the country of incorporation of the audit client differs from the country where the third-country audit entity is incorporated or has its main office, it should contact the responsible authorities of the relevant member State. A relevant audit client is a company incorporated outside the European Union or European Economic Area whose transferable securities are admitted to trading on a regulated market of any member State of the European Union or European Economic Area within the meaning of point 14 of article 4(1) of Directive 2004/39/EC. This refers to an issuer as defined in article 2(1)(d) of Directive 2004/109/EC, except when the company is an issuer exclusively of debt securities admitted to trading on a regulated market in the relevant member State of the European Union or European Economic Area within the meaning of article 2(1)(b) of Directive 2004/109/EC, the denomination per unit of which is at least €50,000 or, if debt securities are denominated in another currency, equivalent, at the date of issue, to at least €50,000, or the company is an issuer exclusively of units issued by collective investment undertakings other than closed-end type or units acquired or deposited in such collective investment undertakings within the meaning of article 1(2) of Directive 2004/109/EC. Such registration does not give approval to carry out statutory audits as required by community law (see article 2(1) of Directive 2006/43/EC), nor does it recognize the qualifications of third-country auditors. If an applicant does not meet the requirements of Commission Decision 2008/627/EC or Commission Decision 2011/30/EU, amended by Commission Implementing Decision 2013/288/EU, member States must apply article 45 of Directive 2006/43/EC, which means that full registration is required.

Information submitted by a third-country audit entity is treated as confidential. According to article 36(2) of Directive 2006/43/EC, the obligation of professional secrecy shall apply to all persons who are employed or have been employed by the responsible authorities. This applies in particular with regard to the outcome of an external quality assurance review in accordance with article 1(1)(e) of Commission Decision 2008/627/EC or article 2(1)(e) of Commission Decision 2011/30/EU, amended by Commission Implementing Decision 2013/288/EU. Information covered by professional secrecy may not be disclosed to any other person or authority except by virtue of the laws, regulations or administrative procedures of a member State. Some information is stored in the register in electronic form and electronically accessible by the public. Information submitted by a third-country audit entity is also subject to data protection rules. All authorities in member States are subject to data protection provisions according to Directive 95/46/EC. However, some information is publicly available in the register.

A description of an applicant's internal quality control system should include, at least, a description of the policies designed to provide reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements (and that reports issued by the firm or engagement partners are appropriate in the circumstances), and a description of the procedures necessary to implement and monitor compliance with such policies.

An external quality assurance review may be a peer review under the supervision of a professional body or independent public oversight body, a review carried out by a professional body, a review carried out by a professional body under the supervision of an independent public oversight body or an inspection by an independent public oversight body in any jurisdiction. An external quality assurance review should comprise both an assessment of procedures throughout an audit firm (including compliance with applicable auditing standards and independence requirements, quantity and quality of resources spent, audit fees charged and internal quality control system) and adequate testing of selected audit files. It is important to note that this obligation only applies if an external quality assurance review has been carried out and a corresponding report exists. Auditors of non-European Union third countries registered in Belgium are subject to similar Belgian oversight (including quality assurance and surveillance) unless in the previous three years they were subject to a quality assurance review either in another member State of the European Union or in a non-European Union third country considered by the European Commission or by the Belgian oversight system as equivalent, under reciprocity.

2. Institutional setting

The Chamber of Disciplinary Transfer and Indictment, created on 31 July 2007, has the ultimate responsibility for quality assurance and surveillance, including investigation, of registered auditors (including individuals and audit firms). This oversight body is responsible for oversight of registered auditors of public interest entities and non-public interest entities, including large commercial companies and not-for-profit associations subject to statutory audits. The Chamber is a member of the International Forum of Independent Audit Regulators and cooperates with other auditor oversight bodies including, among others, those in the European Union under the regime established under Directive 2006/43/EC. The registered auditor public oversight system is composed of the following:

(a) High Council for Economic Professions, composed of seven members appointed by the King (Government) and with the support of two full-time employees who may rely on facilities of the Ministry of Economy. The Council offices are in the Ministry of Economy, and it is financed by contributions from the Institute of Registered Auditors, the Institute of Accountants and Tax Consultants and the Institute of Accounting Professionals and Tax Experts (its budget in 2012 was €341,000)

(b) Chamber of Disciplinary Transfer and Indictment, composed of three members appointed by the King (Government) and with the support of a permanent administrative assistant and other external experts. The Chamber is fully financed by the Institute of Registered Auditors under the law dated 22 July 1953 (its annual budget was €423,000 in 2011, increased by the leasing of office space and related facilities). In 2011, the Chamber relied on quality assurance reviews performed by 67 (non-full time) inspectors (registered auditors) and five (non-full time) external inspectors (non-registered auditors)[135]

(c) Attorney General, as part of the judicial system, and financed by the Government

(d) The disciplinary chambers and chambers of appeal, composed of 32 (non-full time) members (three effective and three substitute French-speaking in the first degree, three effective and three substitute Dutch-speaking in the first degree, five effective and five substitute French-speaking in appeals and five effective and five substitute Dutch-speaking in appeals). The offices and secretariat are hosted by the Institute of Registered Auditors

(e) Advisory and Supervisory Committee on Auditor Independence, whose members were appointed until 2008. The Committee was financed by a contribution by commercial companies representing an annual contribution of €170,000

Process for monitoring and enforcement

The process for MCE of the audit and assurance framework and standards is defined in Directive 2006/43EC, in the law dated 22 July 1953, as amended on 30 April 2007, in its implementation by the Royal Decree dated 30 April 2007 on quality assurance and on surveillance, and in the standards for quality assurance reviews.

Quality assurance reviews of registered auditors are conducted every three years of the auditors of public interest entities and every six years of auditors of non-public interest entities. Reviews are performed by inspectors appointed by the oversight authority (Chamber of Disciplinary Transfer and Indictment) following proposals made by the Institute of Registered Auditors. Inspectors report either to the Quality Assurance Commission (composed of registered auditors) of the Institute or directly to the Chamber. The Quality Assurance Commission reports to the Board of the Institute, which reports to the Chamber. At each stage, the Chamber may request information regarding the ongoing review and has the right to perform the review itself. The final decision on the result of each review is made by the Chamber, and may consist of a positive conclusion, recommendations (to be followed up), an anticipated quality assurance review (for example after one year, instead of three or six years) or a disciplinary procedure against a registered auditor (individual and/or audit firm) before the disciplinary authorities.

The surveillance of registered auditors occurs on the basis of different sources, such as a complaint by a client or by any other person, a question by the Ministry of Economy, Attorney General or an oversight body, press articles, the bankruptcy of an audited company and sectorial investigations. Based on information, the surveillance commission (composed of registered auditors) of the Institute of Registered Auditors or the

[135] Chamber of Disciplinary Transfer and Indictment, 2012, Annual report, available at http://www.kvi-crme.be/fr/informations/annualreports.

Chamber of Disciplinary Transfer and Indictment may initiate an investigation against a registered auditor of public interest and non-public interest entities (individual and/or audit firm). Only the Chamber may decide whether to close a case involving complaints against a registered auditor. Based on an investigation, the Chamber decides whether to close a case or bring it before the disciplinary authorities.

The disciplinary authorities are composed of a majority of non-registered auditors, and are chaired by professional judges of the judicial order, appointed by the King (Government). The authorities may decide on the following sanctions in cases of disciplinary condemnation: official warning; reprimand; prohibition to perform specific audit engagements (for a limited period of time); suspension from the public register, implying a prohibition to perform audit engagements and to use the professional title of registered auditor (for a limited period of time); and removal from the public register of auditors (implying publication), implying a prohibition to perform audit engagements and to use the professional title of registered auditor. An appeal against a decision by a disciplinary chamber in the first instance may be filed with the disciplinary appeal commission. An appeal against a decision by the commission may be filed with the Supreme Court.

The Ministry of Economy, Attorney General and Chamber of Disciplinary Transfer and Indictment, as part of the auditor oversight system, are exclusively composed of and governed by non-registered auditors and are independent from the profession. Their financing is determined under legislation and not by the audit profession. Disciplinary chambers are composed of a majority of non-registered auditors. The members of the oversight authorities cannot be part of a procedure in which they may have a conflict of interest.

In 2011, the Chamber of Disciplinary Transfer and Indictment performed 255 quality assurance reviews, which resulted in the following: 33 full complaints; 65 complaints with points of attention addressed to registered auditors; 11 complaints with recommendations; 20 conclusions with recommendations; 18 conclusions implying an early quality review; and 108 reviews with no object.[136]

With regard to surveillance, the Chamber of Disciplinary Transfer and Indictment started 39 investigations in 2011 (38 of which were proposed by the Institute of Registered Auditors) and decided to bring 10 cases before the disciplinary authorities.[137] In the relevant cases (which constituted the minority of cases), the main findings and recommendations by the Chamber were related to requirements for registered auditors under standards on auditing to analyse the internal control of an audited entity and establish more systematic appropriate confirmation by third parties in the context of statutory audits. The Chamber also focused on independence requirements. In 2011, the disciplinary chambers made 12 decisions and the disciplinary appeal commissions made nine decisions. Most decisions were related to the application of technical standards, including one representation letter.

With regard to confidentiality, auditor oversight authorities and the Institute of Registered Auditors may require registered auditors to access all relevant information including, but not limited to, audit files and evidence. The authorities are subject to professional secrecy and entitled to share information with others only in situations determined by law. Other legislative provisions of public order apply to Belgian authorities, organizations and individuals, including privacy and data protection and labour laws.

Interaction with audit standard setters and other regulators

The High Council for Economic Professions is responsible for national and international cooperation with auditor oversight authorities and also, together with the Ministry of Economy, for endorsing standards on auditing. The Council is a member of the European Group of Auditors' Oversight Bodies. Under the law, the Council must consult the Financial Services and Markets Authority (for listed companies) and National Bank of Belgium (for credit institutions and insurance companies) on quality assurance standards related to public interest entities.

In compliance with Directive 2006/43/EC, article 458 of the Criminal Code and the law dated 22 July 1953 state that auditor oversight authorities in Belgium are entitled to exchange information and cooperate with other auditor oversight authorities in other European

[136] Ibid. The 108 reviews with no object were related to audit firms that were a one-person company that consisted of intermediation between an individual and an audit firm (already subject to a quality assurance review). These companies were not appointed to perform statutory audit engagements as such.

[137] Ibid.

member States, provided that these States have also implemented, as required, this Directive.

Auditor oversight authorities in Belgium are also entitled to exchange information and to cooperate with other auditor oversight authorities in a non-European member State provided that there is a mutual reciprocity agreement endorsed by the King (Government). As authorities can access audit files that include trade secrets and other information protected under professional secrecy, a similar level of protection of confidential information should exist in cooperating with other authorities.

D. MONITORING COMPLIANCE WITH CODES OF PROFESSIONAL CONDUCT AND OTHER APPLICABLE PROFESSIONAL MEMBERSHIP REQUIREMENTS

Under the law dated 22 July 1953, auditors (individuals) may become registered after a three-year traineeship and must have a master's degree. Audit firms may be registered provided that the majority of voting rights and majority of directors are registered auditors in the European Union (either in Belgium or another member State), under Directive 2006/43/EC.

Registered auditors (individuals) are subject to a compulsory permanent education requirement of 120 hours in a three-year period. This requirement for continuing education is monitored as part of quality assurance reviews. Reviews related to education requirements may lead, for example to recommendations or, in the event of an infringement (usually combined with infringements of auditing standards), to disciplinary proceedings. In the event of a lack of knowledge on specific topics identified through a review, the yearly education programme provided by the Institute of Registered Auditors may be reinforced (for example for specific IFRS or International Standards on Auditing). A code of conduct is contained in the royal decree dated 10 January 1994 and in a standard on independence rules (including compulsory partner rotation after six years) dated 30 August 2007. Most of the other independence rules and principles are contained in the law dated 22 July 1953 and in the Companies Code (including a cooling-off period of two years and a list of seven incompatible non-audit services considered to impair an auditor independence).

Under the law on economic professions dated 22 April 1999, members of the Institute of Accountants and Tax Consultants and members of the Institute of Accounting Professionals and Tax Experts should hold a three-year traineeship and a bachelor's degree. Similar continuing professional development requirements apply and codes of conduct are adopted by royal decree. The Institute of Registered Auditors and the Institute of Accountants and Tax Consultants are both members of the European Federation of Accountants and IFAC, and are subject, among others, to the International education standards and the Code of Ethics of the International Ethics Standards Board for Accountants.

As at 31 December 2013, the Institute of Registered Auditors had 41 employees (full-time equivalent) and a total balance sheet of €5.3 million with a turnover of €7.8 million, the Institute of Accountants and Tax Consultants had 25 employees and a total balance sheet of €5.2 million and the Institute of Accounting Professionals and Tax Experts had 20 employees and a total balance sheet of €3 million.[138]

E. CONCLUSION

This case study elaborates on the MCE mechanisms operational in Belgium. There is a wide range of institutions involved in the process of MCE of applicable standards and codes of corporate reporting and this study provides a number of examples of how these institutions conduct their MCE activities. Although Belgium is relatively small when compared to other members of the European Union, it has three professional accounting organizations that meet the specific needs of their respective members. This study illustrates the interaction between national, regional and international institutions responsible for promoting compliance with applicable standards and codes of corporate reporting. Member States considering the implementation of MCE mechanisms may find the mechanisms and processes discussed in this study useful.

[138] For more information on the annual accounts for 2013 of the Institute of Registered Auditors, see http://www.ibr-ire.be/fr/publications/series_actuelles/rapport_annuel/Pages/default.aspx, and for more information on the annual report and accounts for 2013 of the Institute of Accountants and Tax Consultants, see http://www.iec-iab.be/fr/institut/Pages/rapport-annuel.aspx.

CHAPTER IV. CASE STUDY: CANADA

A. INTRODUCTION

This case study provides an overview of how accounting and reporting standards are monitored and enforced in Canada, based on recent data, reports and analyses.[139] The study comprises five sections. First, it provides an overview of Canada's general economic environment, critical industries, growth prospects and stock markets. The framework underlying financial reporting standards and auditing is then detailed. Second, it discusses how compliance with financial reporting standards is monitored and enforced. Third, it presents a similar discussion on compliance with auditing standards. Fourth, it discusses how Canada's accounting profession is structured, including certification, continuing education, ethics and disciplinary mechanisms. Finally, the fifth section presents a synthesis of the material presented and discusses how the different actors in the Canadian financial reporting scene interact and articulate their actions.

Before describing how compliance with accounting and financial reporting standards is monitored and enforced in Canada, it is important to highlight five caveats with regard to the analysis in this study, all of which relate to the fact that Canada is a federation, where the national and provincial governments have both exclusive areas of involvement or jurisdiction and joint areas of interest where there is potential for overlap or, alternatively, coordination.

First, since 1934, through an amendment to the Canada Companies Act, the Federal Parliament has formally recognized the role of CPA Canada in the setting of accounting standards (or more precisely, the role of its predecessor, the Canadian Institute of Chartered Accountants, then known as the Dominion Association of Chartered Accountants). These standards were collected in the Canadian Institute of Chartered Accountants handbook. In 1972, the Canadian Securities Administrators (through which the provincial securities markets regulators coordinate their work) determined that the handbook should be used as the basis for the Canadian GAAPs. In 1975, in enacting the Canada Business Corporations Act, the Federal Parliament formally incorporated a reference to the Canadian Institute of Chartered Accountants handbook as providing a basis for the jurisdiction of the Canadian GAAPs in the enactment of accounting standards for the private sector. In practice, since 1936, that power has been delegated to various committees of the Canadian Institute of Chartered Accountants, leading to the creation of the Accounting Standards Board (AcSB) in 1991. Similarly, the enactment of auditing standards is under the exclusive jurisdiction of CPA Canada through the Auditing and Assurance Standards Board. Following a governance reform in 2000, both boards are now monitored by oversight councils, with all funding provided by CPA Canada.

Second, the regulation of securities markets is an area of provincial jurisdiction, a fact that was recently reaffirmed by the Supreme Court of Canada.[140] There are thus 13 provincial securities regulators in Canada, which coordinate their work through the Canadian Securities Administrators. Most regulations and guidelines dealing with securities markets and market registrants are issued on a national basis through the Canadian Securities Administrators, after a consultative process. MCE is performed at the provincial level. In recent years, a passport regime has emerged by

[139] This case study was prepared for UNCTAD by Michel Magnan, Professor, Concordia University, Canada.

[140] The Court stated the following: "In sum, the proposed Act overreaches genuine national concerns. While the economic importance and pervasive character of the securities market may, in principle, support federal intervention that is qualitatively different from what the provinces can do, they do not justify a wholesale takeover of the regulation of the securities industry which is the ultimate consequence of the proposed federal legislation. A co-operative approach that permits a scheme recognizing the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available and is supported by Canadian constitutional principles and by the practice adopted by the federal and provincial governments in other fields of activities" (Supreme Court of Canada, 2011, Reference re Securities Act, available at http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/7984/index.do (accessed 4 January 2016)).

which a publicly traded entity is only regulated by its home province securities regulator, thus giving the firm a passport to issue securities in other provinces without further oversight. However, as at September 2014, Ontario – the largest province by population and home to Canada's leading stock market, the Toronto Stock Exchange – had not accepted joining the other provinces in this regime. The federal Government is currently attempting to extend the scope of its involvement in securities markets oversight, mostly through its responsibility with regard to systemic risk in the financial system.

Third, in Canada, professions are under provincial jurisdiction, with some national harmonization or coordination depending on the profession involved. Individual CPAs are thus members of provincial institutes and must therefore practice according to the by-laws, statutes and rules of these institutes. However, control over entry into the profession is delegated to the national organization, CPA Canada, with strong provincial input. Moreover, oversight of audit firms dealing with publicly traded entities has been delegated to CPAB, a national organization.

Fourth, the Canadian accounting profession is completing a major overhaul of its structure, with the merger of three independent and rival accounting organizations into CPA Canada. This merger, involving more than 40 national and provincial organizations operating under 14 different jurisdictions, is now almost complete and has led to an extensive redefinition of entrance standards into the profession and even of the profession itself. In sum, the professional education programme that prepares candidates is being redesigned and harmonized across all provinces, with a focus on the acquisition of competencies and the possibility for candidates to choose different career paths with differential educational requirements and knowledge and competency tests.

Fifth, consistent with Canada's federal system, courts and judicial powers are also divided between the government levels. The federal Government is responsible for the enactment of criminal law while civil law falls under provincial jurisdiction. Moreover, while Canada is often considered a common law country in the legal tradition of the United Kingdom, it must be noted that the province of Québec relies on code law, which imposes different obligations on individuals and corporations.

Country overview

While the Canadian economy weathered the financial crisis in 2008 with seemingly little damage, economic recovery since then has been relatively tepid. In 2013, Canada's gross national product reached Can$1.9 trillion (nominal amount), for a population of slightly above 35 million. Over the past few years, economic growth has averaged close to 2 per cent per year and inflation, as reflected in the consumer price index, has reached around 2 per cent.[141]

With regard to industries, similar to many other developed nations, services account for more than 70 per cent of Canadian economic activity (as reflected in GDP). Among services, the most important are finance, insurance, real estate, rental and leasing and management of companies and enterprises (21 per cent of total GDP); retail and wholesale trade (12 per cent), health (8 per cent) and public administration (6 per cent). Manufacturing accounts for 13 per cent of output and construction for 6 per cent. While resources (mining and oil and gas extraction) constitute only 4 per cent of GDP, they represent a sizeable proportion of Canada's exports, as Canada is a net exporter of energy.

The Canadian stock market is fairly developed, with one senior stock exchange (Toronto Stock Exchange) and one for emerging or growth firms (Toronto Stock Exchange Venture Exchange). As at 31 December 2013, the total stock market capitalization of Canada's listed firms was slightly above Can$2.2 trillion, or more than 100 per cent of its gross national product. However, Canada's stock markets are highly concentrated, with close to 70 per cent of total stock market capitalization represented by firms comprising the Standard and Poor Toronto Stock Exchange 60 Index and the remainder split between thousands of firms. Furthermore, in the index, firms from the financial services (around 35 per cent) and resources (oil, gas and materials; around 38 per cent) sectors contribute the bulk of stock market capitalization. Over the years, many foreign firms have withdrawn their listings from the Canadian market.[142]

[141] Statistics Canada, Canada: Economic and financial data, available at http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/dsbbcan-eng.htm.

[142] For more information, see the Toronto Stock Exchange indices and constituents, available at http://web.tmxmoney.com/tmx_indices.php?section=tsx&index=^TX60.

A particular feature of Canadian capital markets is the extent to which Canadian firms cross-list their shares on United States markets. According to SEC, as at 31 December 2013, 318 Canadian firms were registered as foreign private issuers in the United States, representing by far the largest group from any country in the world. Many of Canada's largest corporations have cross-listed their shares in the United States and are thus subject to SEC oversight. These cross-listed firms represent around 62 per cent (Can$1.4 trillion) of Canada's total stock market capitalization.

Another feature of Canadian capital markets is the prevalence of closely held firms, which are often family controlled. According to some recent figures, 53 per cent of the 253 firms comprising the Standard and Poor Toronto Stock Exchange Index have a dominant shareholder holding more than 10 per cent of outstanding equity, with 18 per cent of these firms controlled by a majority shareholder who owns more than 50 per cent of equity. Firms with a dominant shareholder represent around 40 per cent of the country's stock market capitalization.

Similar to the situation prevailing in most developed countries, the Canadian public accounting profession is highly concentrated. For example, among the leading 30 public accounting firms in Canada, the leading seven firms generated close to 90 per cent of overall revenues. The market leaders are (according to 2013 revenue figures) Deloitte (Can$1.8 billion), PricewaterhouseCoopers (Can$1.2 billion), KPMG (Can$1.2 billion) and Ernst and Young (slightly less than Can$1 billion). The second tier of national firms includes Grant Thornton, MNP and BDO, each with revenues of around Can$500 million. Other firms are mostly provincial or local in scope.

As noted above, the accounting profession is close to being unified across the country, with the common designation of CPA. An individual CPA must be a member of a provincial institute (or ordre in Québec) of CPAs. Only CPAs licensed as auditors may perform audits, with licensing requirements set at the provincial level.

Since 2011, publicly accountable entities must prepare their financial statements according to IFRS. However, other reporting regimes also exist. For example, privately held enterprises may report according to IFRS or a separate set of standards designated as accounting standards for private enterprises. Not-for-profit entities and non-governmental organizations have the same option but are also provided with additional standards consistent with their unique characteristics. Finally, public sector entities must adhere to public sector accounting standards, which are set by the public sector AcSB.

B. MONITORING COMPLIANCE WITH THE FINANCIAL REPORTING FRAMEWORK

1. Regulatory basis

While AcSB is responsible for enacting financial reporting standards, MCE is under the responsibility of provincial securities regulators, otherwise known as securities commissions (such as the Ontario Securities Commission) and as the Autorité des marchés financiers in Québec.[143] The powers devolved to each provincial securities regulator are delineated by that province's Securities Act. Collectively, the provincial securities commissions and the Autorité des marchés financiers coordinate their activities and share information through the Canadian Securities Administrators. Globally, as stated in the mission statement of the Canadian Securities Administrators, the mission of provincial securities regulators is to "give Canada a securities regulatory system that protects investors from unfair, improper or fraudulent practices and fosters fair, efficient and vibrant capital markets, by developing a national system of harmonized securities regulation, policy and practice".[144] In this context, through securities regulations, the Canadian Securities Administrators pursues three objectives, two of which emanate from its mission statement (investor protection and fair markets) and the third of which entails the reduction of systemic risk linked to the failure of market intermediaries.

Complementing the securities markets regulatory efforts of provincial regulators are those of self-regulated organizations. One such organization is the Investment Industry Regulatory Organization

[143] The Autorité des marchés financiers has a broader mandate than its counterparts in other provinces as, in addition to its oversight of securities markets, it is also the regulatory agency for financial institutions with a provincial charter such as credit unions, property and liability insurers and life insurers.

[144] Canadian Securities Administrators, Our mission, available at http://www.securities-administrators.ca/our-mission.aspx (accessed 4 January 2016).

of Canada, whose mandate is to set and enforce rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees, through setting and enforcing market integrity rules regarding trading activity in Canadian equity marketplaces. Other such organizations are the Chambre de la sécurité financière in Québec (for investment representatives) and Mutual Fund Dealers Association of Canada. Self-regulated organizations may discipline member dealers or their employees for breaching their rules. Sanctions include suspension or termination of membership or market access and monetary penalties.

With regard to reporting, the Canadian GAAPs, as adopted by AcSB, require entities that are publicly accountable (which encompasses firms listed on a stock exchange) to use IFRS (subsection 3.2(1) of National Instrument 52-107 states that financial statements must be prepared in accordance with Canadian GAAPs applicable to publicly accountable enterprises. See appendix IV.I for further information about accounting standard setting in Canada). For Canadian firms cross-listed in the United States, the use of IFRS allows them to avoid reconciliation between earnings under Canadian GAAPs and earnings under United States GAAPs (as long as financial statements rely on IFRS as issued by the International Accounting Standards Board), known as 20-F reconciliation. Other relevant regulations include National Instrument 51-102, on the disclosure of material facts and events, and Canadian Securities Administrators Staff Notice 52-306, delineating the measurement and reporting of non-GAAPs performance metrics (which must be reconciled with GAAPs earnings). Canadian securities regulators allow firms registered as foreign private issuers in the United States to use that country's GAAPs for their financial reporting instead of IFRS (under subsection 3.7(1) of National Instrument 52-107). On the basis of the most recent annual financial statements filed for the year ended 31 December 2013, of 239 foreign private issuers in the United States domiciled in Canada, 75 per cent (178) used IFRS, while 24 per cent (58) used United States GAAPs (three firms used pre-IFRS Canadian GAAPs pending the resolution of reporting requirements for regulatory assets by the International Accounting Standards Board).[145] According to National Instrument 51-102, all publicly listed firms must publish their financial statements on a quarterly basis, with annual financial statements audited by a public accountant.

2. Institutional setting

While harmonized through the Canadian Securities Administrators, there are slight variations across provinces with regard to MCE. Unless specifically mentioned, therefore, this study focuses on the Ontario Securities Commission, the regulator in Canada's largest province by population, which is home to its leading stock exchange. According to its latest annual report, the Ontario Securities Commission regulates firms and individuals that sell securities and provide advice in Ontario, as well as public companies, investment funds and marketplaces (such as the Toronto Stock Exchange).[146] In general, issuing and publicly traded firms registered in Ontario are regulated by the Ontario Securities Commission.

With regard to monitoring compliance with securities laws and regulations, the Ontario Securities Commission has several tools at its disposal. For example, the Commission may issue a cease trade order on an issuer's securities, order a public company or investment fund to restate and refile its financial statements or impose terms and conditions on a registration. If such means are deemed insufficient, then enforcement actions may be taken. For example, if an individual or company contravenes securities law, the Commission may initiate an enforcement proceeding against them. These types of cases are heard by an administrative panel of commissioners who act as independent adjudicators. In administrative proceedings, the tribunal may, among other sanctions, impose monetary sanctions, order individuals or firms to disgorge ill-gotten gains and ban individuals from trading or from leadership roles in issuers, either temporarily or permanently. Moreover, in certain cases, provincial securities legislation also gives the Commission the authority to prosecute accused wrongdoers through the Ontario courts, which may impose jail terms as a possible sanction. Typically, individuals and companies alleged to have perpetrated fraud and other misconduct are pursued through administrative proceedings before the Commission tribunal and quasi-criminal matters before the Ontario Court of Justice. In quasi-criminal

[145] Data compiled from publicly available sources for AcSB.

[146] Ontario Securities Commission, 2013, Annual report 2013, available at https://www.osc.gov.on.ca/documents/en/Publications/rpt_2013_osc-annual-rpt_en.pdf (accessed 4 January 2016).

proceedings, the Court may impose jail sentences for violations of the Securities Act (Ontario) and breaches of Commission orders, and thereby send a strong deterrence message. However, as a regulatory body, the Commission does not normally recover money for investors.

It must be noted that the reach of securities regulators extends beyond firms whose shares are listed on an exchange to encompass all enterprises whose shares are deemed publicly traded; hence use of the term "publicly accountable" to define which firms must apply IFRS.

3. Human and financial resources

The resources devoted to securities regulation are mostly derived from fees imposed on securities issuers. In 2013–2014, based on their latest financial statements, the budgets of the four largest provincial regulators were as follows:[147]

(a) Ontario Securities Commission: Can$97 million

(b) Québec Autorité des marchés financiers: Can$90 million

(c) British Columbia Securities Commission: Can$48.5 million

(d) Alberta Securities Commission: Can $35.5 million

Overall, regulators for Canadian securities markets expended about Can$300 million in the most recent period to pursue their missions. To provide some context, in 2013, the overall budget of SEC was $1.33 billion (about the same amount in Canadian dollars). The two markets are quite different in terms of scope and number of registrants, with the total stock market capitalization of the United States about 10 times that of Canada, and even greater if cross-listed firms are included.[148] Moreover, the United States has a much more active initial public offering setting than that in Canada, with 146 firms raising $43 billion in 2012 (as against 11 firms raising Can$1.7 billion in Canada). However, relative to United States markets, Canadian markets are characterized by a larger number of micro-cap firms.[149] Moreover, the mandates of the regulators are quite different, between provinces and between Canada and the United States, thus making comparisons more difficult.

With regard to human resources, the Ontario Securities Commission has around 480 employees while the Autorité des marchés financiers has slightly more than 650. In contrast, at the end of 2013, SEC had 4,138 employees. However, from publicly available information, it is difficult to ascertain how much of financial and human resources are devoted to enforcement activities that relate to financial disclosure by listed entities. For example, the 2013 financial statements of the Autorité des marchés financiers indicate that close to Can$11 million was spent on inspections and investigations outside of direct costs arising from regular activities (13 per cent of its operating budget) and Can$7.1 million on litigation (8 per cent of its operating budget), implying that enforcement expenses represented around 21 per cent of its total operating expenses.[150] In contrast, in 2013, SEC devoted $451 million (34 per cent of its operating budget) to enforcement.[151] These figures suggest that Canadian market regulators spend a relatively smaller share of their operating budget on enforcement than SEC.

Conversely, compliance-related costs represent a much larger proportion of the operating budget for Canadian regulators than for SEC. In 2013, the programme-driven costs – essentially compliance focused – of the Autorité des marchés financiers reached around Can$32 million (32 per cent of operating expenses) but the same costs of SEC totalled $265 million (barely 20 per cent of programme costs). While several interpretations are possible, such a major difference in spending priorities may be a reflection of two underlying trends. From a practical perspective, Canadian securities regulators oversee around 6,000 publicly traded companies. In comparison, with a much larger market and more resources, SEC oversees around 12,000 publicly

[147] The budgets for the remaining nine provincial regulators total less than Can$30 million, and the next largest regulator, Saskatchewan's Financial and Consumer Affairs Authority, has a budget of only Can$7.5 million.

[148] World Bank database, Market capitalization of listed domestic companies, available at http://data.worldbank.org/indicator/CM.MKT.LCAP.CD.

[149] C Carpentier and J-M Suret, 2010, The Canadian public venture capital market, *Strategic Change*, 19(7-8):303–323.

[150] Autorité des marchés financiers, 2014, 2013–2014 annual report, available at http://www.lautorite.qc.ca/fr/rapports-annuels-org-pro.html (accessed 4 January 2016).

[151] SEC, 2013, Fiscal year 2013 agency financial report, available at http://www.sec.gov/about/secafr2013.shtml (accessed 4 January 2016).

traded entities.[152] The large number of publicly traded entities in Canada, relative to the size of its market, forces regulators to expend more resources on compliance. However, the contrast in spending priorities may also reflect a different strategy, with Canadian regulators devoting more resources to prevention and SEC focusing on prosecuting high-profile cases that may serve as warnings. Overall, it appears adequate resources are allocated to MCE of securities markets in Canada.

4. Process for monitoring and enforcement

With regard to the administrative structure of the Ontario Securities Commission, the key units responsible for MCE of financial reporting standards are the enforcement branch and Office of the Chief Accountant. Canada's key provincial securities regulators all have an Office of the Chief Accountant. This Office is responsible for creating and promoting a high-quality framework for financial reporting by market participants and is thus actively involved in monitoring disclosure and financial reporting by issuers. On a regular basis, the Office publishes staff notices or reports that highlight areas in which disclosure or financial reporting is lacking or does not quite meet expectations as per accounting standards, including IFRS. For example, in September 2013, the Office published Ontario Securities Commission Staff Notice 52-721 on the application of IFRS 8 (operating segments) and International Accounting Standard 36 (impairment of assets), detailing many practices that fell short of requirements.

Beyond compliance monitoring by the Office of the Chief Accountant and other operating branches such as for corporate finance and market regulation, the securities regulator relies on complaints from the public and market participants to assess cases. Provincial regulators typically have a dedicated page on their websites that targets investors. For example, the page on the Ontario Securities Commission website urges investors to contact the Commission if they have a question, want to report suspicious activity, or lodge a complaint against a company, investment product or financial adviser.[153] The largest regulators offer investors formal help in formulating and lodging complaints. With regard to the evolution of such complaints, national figures are not readily available, but figures for Québec are shown in table 1. More or less comparable figures are also available for Alberta and British Columbia, as shown in table 2.

Table 1 Complaints received by the securities regulator in Québec, 2009–2013

	2009–2010	2010–2011	2011–2012	2012–2013
Total number of complaints	1 740	1 408	1 532	1 470
Complaints referred to Autorité des marchés financiers (inspection, investigation, etc.)	867	694	819	653
Complaints referred to self-regulatory bodies	412	525	667	485

Note: Complaints may be directed to more than one service or self-regulatory body. The numbers in the last two rows are not directly comparable to the total number of complaints.

Source: Autorité des marchés financiers, 2014.

Table 2 Number of complaints received by the securities regulators in Alberta and British Columbia, 2012–2014

	2012	2013	2014
Alberta	734	708	583
British Columbia	147	312	201

Sources: Alberta Securities Commission, 2014, Annual report, available at http://www.albertasecurities.com/news-and-publications/Pages/reports-and-publications.aspx (accessed 4 January 2016); British Columbia Securities Commission, 2014, Annual report, available at http://www.bcsc.bc.ca/About_Us/ (accessed 4 January 2016).

No particular trend is evident from the figures shown in the tables. While the figures for Québec are not directly comparable to the figures from Alberta as Alberta's securities regulator has a narrower range of responsibilities, it appears that the number of complaints more or less matches the relative populations of the two provinces (8 million in Québec and 4 million in Alberta). Both provinces run very active advertising and awareness campaigns. The figures for British Columbia are comparatively much lower, despite a population size that is close to Alberta's. The Autorité des marchés financiers indicated in its annual report for 2013–2014 that 68 per cent of the

[152] Deloitte, SEC, available at http://www.iasplus.com/en/resources/regional/sec (accessed 4 January 2016).

[153] Ontario Securities Commission, 2014, Office of the investor: Investor voice, available at http://www.osc.gov.on.ca/en/Investors_inv_news_20140630_thank-you-contacting-osc.htm (accessed 4 January 2016).

complaints ultimately referred to one of its services or to another self-regulatory body had been resolved to the satisfaction of the individual complainant.

Following an initial assessment of the nature and seriousness of a case, if there is evidence of criminal activity, the case is referred to law enforcement agencies (Royal Canadian Mounted Police (the national police force), provincial police, municipal police or special market enforcement task forces). Cases related to self-regulated organizations (mutual fund dealers or investment representatives) are referred to them. Serious cases related to financial reporting and disclosure are typically formally investigated. At this level, the regulator may seek interim cease trade, asset freeze or reciprocal (across jurisdiction) orders if deemed appropriate. Investigations entail gathering evidence and facts, analysing data and documentation and interviewing witnesses and respondents. Consultation with the regulator's counsel determines whether the case goes to litigation. Securities regulators may bring allegations of securities misconduct to a hearing before an adjudicative panel of a securities commission or an associated tribunal. According to securities laws, securities regulators are authorized to seek administrative sanctions for securities-related misconduct, including monetary sanctions and prohibitions on market participation or access. Securities legislation also establishes quasi-criminal offences for contraventions of regulatory requirements and prohibitions of certain activities related to capital markets. Penalties for committing such offences may include a term of imprisonment and a significant fine. In some jurisdictions, a provincial regulator's staff may directly prosecute such cases in court.

Penalties vary across provinces. For example, since 2005, the Ontario Securities Commission has had the power to impose fines of up to Can$1 million on individuals and companies for each failure to comply with securities law. In addition, disgorgement orders may be imposed on respondents to pay the amount obtained as a result of non-compliance with securities law. While there is discretion in the administration of sanctions, their ultimate purpose is to deter others from contravening the Securities Act.[154] In Québec, among its many provisions, the Securities Act, in article 204, provides the Autorité des marchés financiers with the power to impose fines of an amount up to Can$5 million or four times the gains realized as a result of an illegal operation. Securities regulators may refer cases of certain quasi-criminal offences to crown counsel (equivalent to a district attorney in the United States and state prosecutor in other jurisdictions) for prosecution in provincial courts. However, irrespective of a case being investigated and tried, securities regulators have no authority to order a term of imprisonment and only a judge may order such a penalty.

For certain types of offences, the Criminal Code, a federal statute, provides the framework for enforcement. The Criminal Code defines some specific securities-related criminal offences (such as market manipulation) and, more generally, economic crimes (such as fraud) that may also involve some securities-related misconduct. Penalties under the Criminal Code for offences may include a lengthy term of imprisonment and a significant fine. The pursuit of an offence under the Criminal Code requires charges to be laid by law enforcement or the crown. Prosecution is then pursued by the crown counsel.

The increased complexity of many fraud cases, which need to be investigated by specialists who span several disciplines, such as forensic accountants (trained in law, accounting, and finance), has led to the development of closer links between securities regulators and other law enforcement organizations. For example, the Autorité des marchés financiers has entered into a partnership with the Financial Market Crime Unit of the Sûreté du Québec (provincial police force responsible for criminal investigations), the Ontario Securities Commission has set up a Joint Serious Offences Team that works closely with the Ministry of the Attorney General and police agencies and the British Columbia Securities Commission formed a criminal investigation team in 2007 and has since worked on numerous cases with police agencies.

5. Trends

While an overall picture of enforcement efforts may be provided, it is difficult to assess to what extent they relate to financial reporting. On the one hand, enforcement activity is classified under themes such as illegal distribution (of securities), fraud, misconduct by a registrant, disclosure, illegal insider trading, market manipulation and others, all of which may

[154] Ontario Securities Commission, 2015, Sanctions by the Commission, available at http://www.osc.gov.on.ca/en/Proceedings_sanctions-commission_index.htm (accessed 4 January 2016).

or may not entail financial reporting issues. On the other hand, financial reporting misconduct often accompanies violations of other securities laws and regulations, making a direct identification of specific financial reporting cases difficult.

Nationally, aggregate figures from the Canadian Securities Administrators do not show any particular trend with regard to enforcement activity. The total number of enforcement proceedings initiated rose from 352 in 2011 to 388 in 2012 before declining to 270 in 2013. A majority of enforcement actions relate to the illegal distribution of securities and the second highest number relate to fraud allegations. With regard to enforcement actions that concluded in 2013, matters were concluded against 156 respondents following contested hearings (in administrative tribunals), 150 respondents by settlement agreements and 76 respondents by court decisions. Fines and administrative duties imposed totalled Can$52.2 million in 2011, Can$36.6 million in 2012 and Can$35.4 million in 2013, and were mostly for illegal distribution and fraud cases.[155]

While there has been progress over the past few years with regard to the ability and capability of MCE of Canadian securities regulators in financial reporting cases, some observers note that it still lags behind SEC in some respects. For example, according to Rosen and Rosen (2010), United States authorities investigated more than 130 companies, including Apple and Dell, for the backdating of stock options awarded to their executives, and these efforts led to the dismissal of more than 50 executives and directors.[156] In Canada, while the Ontario Securities Commission found reliable evidence that at least 35 Canadian companies had likely engaged in such a practice, only one firm was charged, Research In Motion (now Blackberry), which was also cross-listed in the United States (Nasdaq). Another example is Nortel, which had restated the same financial statement four times, and in the United States, was fined $35 million by SEC. In Canada, the Ontario Securities Commission did not fine Nortel but merely required it to contribute to the costs of its investigation. It is not clear why the Commission chose not to pursue the case further, but whenever there are securities law issues with cross-listed firms one set of regulators may sometimes take precedence in taking action. In 2008, the Royal Canadian Mounted Police brought criminal charges against Nortel's chief executive officer, chief financial officer and controller for financial reporting fraud. However, on 14 February 2013, following a six-month trial, the Ontario Superior Court dismissed all fraud charges against the three executives, ending a process that had started in 2005.

The example of the Live Entertainment Corporation of Canada, known as Livent, provides perhaps the most telling illustration of the difference between the enforcement regimes in Canada and the United States. In a speech made at the twenty-seventh annual American Institute of CPAs National Conference on Current SEC Developments on 7 December 1999, the then-Director of the Division of Enforcement highlighted several of the enforcement actions of SEC in 1998 with regard to financial reporting. Such actions included charges against eight of Livent's top executives plus indictments against its two co-founders in the state of New York. For several years in the 1990s, Livent was the only publicly listed live-entertainment company in North America, producing award-winning shows such as The Phantom of the Opera. Livent went bankrupt in 1998 under allegations of financial reporting misconduct and fraud. In January 1999, Livent reached an administrative settlement with SEC, while civil and criminal proceedings were simultaneously pursued against co-founders Garth Drabinsky and Myron Gottlieb and other former Livent employees. In Canada, the Ontario Securities Commission initiated proceedings against Livent and its principals in 2001, and in 2009, the Ontario Superior Court found both Drabinsky and Gottlieb guilty of fraud and forgery for misstating the company's financial statements between 1993 and 1998. The contrast between the two countries in terms of the time between the critical event (Livent's bankruptcy in 1998) and the initiation of proceedings (1999 in the United States and 2001 in Canada), as well as the length of time before retribution was obtained (11 years after Livent's bankruptcy) is somewhat troubling. Drabinsky was ultimately imposed a prison term of five years following an appeal. The Livent case is the only instance in which senior executives were ever convicted for financial reporting fraud in Canada and sentenced to imprisonment.

[155] Canadian Securities Administrators. 2013 enforcement report, available at https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA-2013-English.pdf (accessed 4 January 2016).

[156] A Rosen and M Rosen, 2010, *Swindlers: Cons and Cheats and How to Protect Your Investments From Them* (Madison Press Books, Toronto).

6. Interaction with financial reporting standard setters and other regulators

There are formal interactions at various levels between standard setters and regulators. For example, the Superintendent of Financial Institutions (regulator for banks and insurance companies with a federal charter) and the Chief Executive Officer of the British Columbia Securities Commission are currently members of the Accounting Standards Oversight Council that oversees AcSB. The current Chief Executive Officer of the Autorité des marchés financiers was until recently a member of the Accounting Standards Oversight Council, and the Chief Accountant of the Alberta Securities Commission is a member of AcSB. Moreover, in responses to exposure drafts, securities regulators frequently comment on proposed accounting standards. As AcSB has a policy of not adopting and implementing any made-in-Canada guidance for IFRS, there is no formal approach to resolving any problem in practice related to the enforcement of a particular standard. Securities regulators may informally contact AcSB on such an issue with the expectation that AcSB will bring the matter to the attention of the International Accounting Standards Board. More formally, securities regulators and/or AcSB may decide to lodge a formal request with the IFRS Interpretations Committee, which decides whether to pursue the matter.

7. International cooperation

Canada's largest provincial securities regulators engage in international cooperation. For example, the securities commissions in Alberta, British Columbia and Ontario and the Autorité des marchés financiers in Québec are fully fledged members of IOSCO, which sets internationally recognized standards for the securities sector. Both the chair of the Ontario Securities Commission and the chair of the Autorité des marchés financiers are members of the IOSCO Board of Directors. In March 2013, the chair of the Ontario Securities Commission was appointed a vice-chair of the IOSCO Board of Directors and, in that capacity, will also chair the IOSCO Monitoring Group, which oversees international auditing standard setting, and the Decision-Making Group for the IOSCO Multilateral Memorandum of Understanding, which sets the requirements for the exchange of information, ensuring that no domestic secrecy laws or regulations prevent the sharing of enforcement information among securities regulators. Other involvement by the Ontario Securities Commission includes participation in the IOSCO Task Force on Financial Benchmarks and Task Force on Cross-Border Regulation.

Canadian securities regulators also have a close working relationship with market regulators in the United States such as SEC and the Commodity Futures Trading Commission. For example, on 10 June 2010, the Autorité des marchés financiers, Ontario Securities Commission and SEC signed a memorandum of understanding that provides a clear mechanism for consultation, cooperation and exchanges of information among the agencies in the context of supervision. The memorandum sets forth the terms and conditions for the sharing of information about regulated entities, such as broker-dealers and investment advisers, which operate in the United States and the provinces of Ontario and Québec.

Interprovincial as well as international cooperation will become even more critical in the future as corporations expand their operations across borders and investors seek opportunities around the world. For example, in pursuing a case against Boyuan Construction Group, a firm listed on the Toronto Stock Exchange but with operations essentially in China, the Ontario Securities Commission received assistance not only from its counterparts in Alberta and British Columbia, but also from securities regulators in the British Virgin Islands and Hong Kong (China).

C. MONITORING COMPLIANCE WITH THE AUDIT AND ASSURANCE FRAMEWORK

1. Institutional setting

The Auditing and Assurance Standards Board is responsible for determining standards in Canada. The Board's decision-making process is subject to monitoring by an oversight board, similar to the structure in place for financial reporting standards. Similar to the situation with regard to financial reporting, in which IFRS are used for publicly accountable entities, since 2010, Canadian auditors must adopt and comply with International Standards on Auditing, which are issued by the International Auditing and Assurance Standards Board. There are currently two Canadians on the Board. With regard to securities markets and reporting entities, direct oversight of their auditors is the responsibility of CPAB.

2. Regulatory scope

The creation of CPAB in 2003 may be seen as Canada's response to the Sarbanes-Oxley Act, one of the provisions of which was the setting up of PCAOB to oversee all audit firms with publicly traded clients. CPAB was jointly set up by the Canadian Securities Administrators, the Office of the Superintendent of Financial Institutions and the Canadian Institute of Chartered Accountants. The CPAB Council of Governors has the primary oversight role and is responsible, in particular, for appointing the board of directors and selecting the chair and vice-chair. The Council of Governors is essentially controlled by Canadian securities regulators. The document that defines the role and powers of CPAB is National Instrument 52-108 on auditor oversight, which requires auditors of reporting issuers to be registered as CPAB participants, and also requires Canadian reporting issuers to issue financial statements audited only by firms registered with CPAB.

As at January 2013, 296 audit firms were registered with CPAB, of which 210 had an active practice and, of these, 38 were foreign affiliates or members of national firms and 45 were other foreign auditors. However, of these 210 firms, only 25 had more than 25 reporting issuers and 50 had 5–24. CPAB concentrates its inspection efforts on these 75 firms, focusing on firms with fewer than five audit clients only if the perceived risk is deemed too high. Otherwise, oversight of the remaining 135 firms with few clients is delegated to provincial institutes that inspect them on behalf of CPAB. Annually, CPAB inspects all firms that audit more than 100 reporting issuers. Such firms audit approximately 99.5 per cent of the total market capitalization of public companies trading in Canada. There are currently 14 firms in this category.

Financial and operating information about CPAB is difficult to obtain and it is not possible to judge whether its resources are adequate to perform its tasks. Securities regulators remain involved if an audit failure or violation has market implications.

3. Interaction with audit standard setters and other regulators

There are formal interactions between audit standard setters and regulators. For example, a senior executive from the Office of the Superintendent of Financial Institutions (regulator for financial institutions with a federal charter) is currently a member of the Auditing and Assurance Standards Board. Moreover, the Chief Accountant of the Ontario Securities Commission and the Chief Executive Officer of CPAB are both members of the Auditing and Assurance Standards Oversight Council.

According to its most recent strategic plan, the Canadian Audit and Assurance Standards Board's stated policy is to adopt International Standards on Auditing without any amendment.[157] If there is evidence of inconsistent application of some audit standards, then securities regulators may bring the matter to the attention of the Board, which will determine whether there are "circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada".[158] Under such circumstances, the appropriate International Standard on Auditing may be modified using due process involving consultations with stakeholders. Alternatively, the matter may be brought to the attention of the International Auditing and Assurance Standards Board.

With regard to other regulators, Canadian audit firms that have clients registered with SEC must be accredited by PCAOB and may therefore be subject to inspections by PCAOB. CPAB and PCAOB typically attempt to coordinate their monitoring activities.

4. Process for monitoring and enforcement

CPAB identifies higher risk clients of firms using a proprietary risk-based model to evaluate the entire population of approximately 8,000 reporting issuers. The model allows for an assessment of reporting issuer-auditors that may represent the most significant risks to the investing public, with the highest potential to exhibit a material error or misstatement. The model takes into account the general economy, industry in which the reporting issuer operates, reporting issuer's financial stability, size and foreign exposure, management's track record, audit firm's risk profile and engagement partner's experience, including past inspection results.

[157] Auditing and Assurance Standards Board, 2013, Strategic plan 2013–2016, available at http://www.frascanada.ca/auditing-and-assurance-standards-board/what-we-do/strategic-plan/item73360.pdf (accessed 4 January 2016).

[158] Ibid.

CPAB does not disclose the outcome of its inspections of specific audit firms. In contrast to PCAOB, which identifies audit firms for which engagement files have deficiencies, CPAB only provides an overview of its inspections and findings with some illustrations, without disclosing the identity of audit firms or reporting issuers. The lack of details prevents a definite assessment of the evolution of audit quality by external observers.

Violation events, as defined by CPAB, may imply that an audit firm is not performing to professional standards and is therefore placing the public at risk.[159] In such instances, CPAB may engage in disciplinary procedures that take one of three forms – requirement, restriction or sanction – with the latter two reported to securities regulators. The severity of the procedures varies from a requirement to take education or training to termination of the status of an audit firm as allowed to audit publicly listed entities. Following inspections completed in 2013, CPAB initiated nine outstanding disciplinary actions (two restrictions and seven requirements).[160] These actions limited the practice of the firms and/or their partners in their reporting issuer audits.

5. Trends

CPAB inspected 49 firms in 2013 (61 in 2012), reviewing a total of 195 engagement files (236 in 2012). In addition, provincial institutes conducted 71 inspections (51 in 2012) on behalf of CPAB. The year-to-year reduction in the number of inspections is due to a change in procedure. The four largest audit firms (Deloitte, PricewaterhouseCoopers, KPMG and Ernst and Young) and 11 other national firms are inspected on an annual basis. CPAB estimates that the four largest firms audit reporting issuers that represent 98 per cent of Canada's total stock market capitalization (Can$2.2 trillion as at 31 December 2013), with the remaining 11 national firms representing another 1.5 per cent.

A majority (105 of 195) of the engagement files reviewed by CPAB pertained to audits performed by the four largest firms. CPAB reported a 43 per cent decline in 2013 (33 per cent in 2012) in files with significant audit deficiencies. Such deficiencies emanate from two sources, which are in fact intertwined. First, CPAB continues to identify a need for firms to enhance the professional scepticism of their staff. CPAB considers that audit deficiencies may usually be attributed to insufficient consideration of the risks of material misstatement arising from estimation uncertainty. Such undervaluation of risk translates into inadequate or inappropriate audit procedures and, too often, a failure to challenge management. Second, deficiency results from complex accounting estimates that involve impairment assessments relying on fair value determinations and the audit of underlying financial projections. Such projections and valuations are often determined by specialists whose judgement, credentials and often optimistic numbers are often not critically assessed by auditors. Findings for the other audit firms were essentially the same, with additional concerns about their reliance on foreign auditors not affiliated with global networks (and thus subject to uniform minimal standards) and on experts retained by management, especially in the resources sector (for reserves estimates).

In recent years, in addition to its support in the creation of CPAB, the Ontario Securities Commission has taken a more active stand with regard to audit failures. More specifically, its reaction follows the launch of several allegations against firms from emerging countries listed on the Toronto Stock Exchange or its Venture Exchange, often as a result of a reverse takeover. Following the Commission's Emerging Markets Issuer Review, a decision was made to put more focus on whether gatekeepers, such as auditors, effectively perform their role, which is to protect investors. The first public outcome of a new strategy was the issuance, in December 2012, of allegations that the former auditors of Sino-Forest Corporation had breached the Securities Act (Ontario) by failing to conduct audits in accordance with relevant standards. Sino-Forest was a China-based forestry company listed on the Toronto Stock Exchange that for a period of time was Canada's largest publicly listed forest products enterprise, with a stock market capitalization

[159] CPAB Rule 103(hh) states that a violation event "means (i) an act or practice, or omission to act, in violation of the rules or professional standards that may have an effect on the provision of audit services to reporting issuers; (ii) a failure to supervise appropriately a person with a view to preventing violations of the rules or professional standards, and such person has committed an act or omitted to act in violation of the rules or professional standards that may have an effect on the provision of audit services to reporting issuers; (iii) a failure to cooperate with the terms of an inspection or investigation; or (iv) a failure to comply with the terms of any requirement, restriction or sanction imposed by the Board" (CPAB, 2006, CPAB Rules, available at http://www.cpab-ccrc.ca/Documents/About/CPAB_RULES_Jun_2006_EN_FNL.pdf (accessed 4 January 2016)).

[160] CPAB, 2013, Public report, available at http://www.cpab-ccrc.ca/Documents/Topics/Public%20Reports/2013_Public_Report_EN.pdf (accessed 4 January 2016).

of around Can$6 billion. Following the publication in 2011 of a report by a United States hedge fund on the reporting and business practices of the firm, its shares lost most of their value before a cease trade order was issued. The firm eventually filed for bankruptcy. While regulatory oversight of auditors has certainly tightened since enactment of the Sarbanes-Oxley Act, oversight by market participants probably has more disciplinary traction, as illustrated by the outcome of three recent cases against auditors brought about by investors or bankruptcy receivers.

On the day the Ontario Securities Commission released news of its allegations against Sino-Forest's audit firm, the firm agreed to settle a securities lawsuit launched by investors in exchange for a payment of Can$117 million. According to the plaintiff's attorneys, it was "the largest settlement by an auditor in Canadian history, by a large margin [and] one of the largest ever auditor settlements worldwide".[161] While there was no admission of guilt by the audit firm and case evidence was sealed by Court decision, the magnitude of the settlement sent a strong signal to auditors as to their responsibilities when performing audits of publicly traded firms.

Another court case that set a precedent in Canada related to the bankruptcy of a real estate investment firm, Castor Holdings Limited. In 2014, the Supreme Court of Canada ruled that it would not hear an appeal from Coopers and Lybrand (a predecessor firm to PricewaterhouseCoopers), the auditor, of a lower court decision holding it liable for professional negligence related to work performed for Castor Holdings from before the firm went bankrupt in 1992. The lawsuit was initially launched by bond investors in Castor.

A third court case related to the bankruptcy of Livent. On 4 April 2014, the Ontario Superior Court ruled that Livent's audit firm had been negligent in its audit of the company's financial statements in 1997 and ordered it to pay Can$85 million to Livent's creditors. Until then, the legal framework for litigations against auditors had been the 1997 decision by the Supreme Court of Canada on the Hercules Managements Limited case, which established that auditors only owed a duty of care to a narrow group of parties, including companies they were hired to work for, but not to all investors broadly. In the ruling, the Court assessed that holding auditors responsible for every potential investor who bought a firm's securities would lead to "an unacceptably broad expansion of the bounds of liability".[162] Since then, therefore, the number of auditor lawsuits filed in Canada has been fairly low. However, the Livent ruling may set a precedent for future proceedings against auditors as it redefines the legal landscape of such cases. More specifically, the case was not filed by creditors or shareholders, but by the company itself through a court-appointed special bankruptcy receiver. Litigation was launched by the receiver on behalf of creditors and financed by two major creditors. Thus, consistent with the framework developed during the Hercules Managements Limited case, the plaintiff was the company itself.

Three conclusions may be reached in considering these court cases. First, none of the three litigations was launched by regulators. Second, through litigation, market participants such as investors have a disciplinary role to play with regard to auditors. Third, the speed of justice may be highly variable; the settlement in the Sino-Forest case came a few months after the firm had gone bankrupt while the ruling in the Castor Holdings case came slightly more than 20 years after its bankruptcy. With regard to the ruling on the Livent case, the delay between bankruptcy and court decision was close to 11 years. However, while it may be a coincidence, the fact that the Ontario Securities Commission launched allegations of audit negligence at about the same time that a settlement was reached in the Sino-Forest case illustrates that regulatory and investor-led judicial actions may enhance MCE of auditing with regard to financial reporting.

D. MONITORING COMPLIANCE WITH CODES OF PROFESSIONAL CONDUCT AND OTHER APPLICABLE PROFESSIONAL MEMBERSHIP REQUIREMENTS

1. Institutional setting

As noted in the introduction, the Canadian accounting profession is currently changing, with the three legacy organizations – representing chartered accountants, certified management accountants and certified general accountants – in the final stage of merging

[161] *Market Wired*, 2012, Siskinds and Koskie Minsky announce $117 million settlement with Ernst and Young in Sino-Forest class action, 3 December, available at http://www.marketwired.com/printer_friendly?id=1733045 (accessed 4 January 2016).

[162] Supreme Court of Canada, 1997, Hercules Managements Limited v. Ernst and Young, available at http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1511/index.do (accessed 4 January 2016).

their provincial and national entities. Consistent with changes at the institutional level, entry into the profession is also being revamped, with a new professional education programme set for deployment in 2015. This case study therefore focuses on the future, with the information currently available. Analysis is restricted to the process leading to the practice of public auditing. The underlying assumption is that current merger plans will be successful and that the only entity remaining will be CPA Canada, with 13 provincial and territorial CPA institutes.

In Canada, entry into the profession typically entails an undergraduate business education with a major in accounting (alternative routes may be available). Candidates are then expected to enter into a professional education programme whose standards and learning objectives are uniform across the country but whose delivery is decentralized at the provincial level as, according to the Constitution of Canada, education is under provincial jurisdiction. Candidates who wish to become auditors must take a specific educational path that emphasizes auditing and financial reporting training and must also pass nationwide common examinations. In addition to formal education, all provinces require aspiring CPAs to perform articling duties before receiving certification. In practice, the term of such articling ranges from two to three years, with many candidates studying in parallel.

Licensing requirements with regard to becoming a public accountant (auditor) are set at the provincial level and procedures vary across provinces. For example, in Ontario, the Public Accountants Council designates who may perform audits and in Québec, the law creating the Ordre des CPA defines public accounting and restricts its practice to CPAs accredited by the Ordre. However, the merger of the profession is likely to bring greater harmonization. It is important to note that CPAs self-select themselves as either public practice accountants or non-public practice accountants. Under the new professional education programme, candidates must choose between four educational paths, of which auditing and financial reporting is required to eventually become a public accountant.

2. Regulatory scope

Once licensed as public accountants, CPAs are subject to regular professional inspections of work files (on a fee basis) performed by provincial institutes. Failure to comply with financial reporting and auditing standards and good practices may ultimately lead to temporary suspensions or outright expulsion from an institute. Regulatory oversight of CPA institutes is the responsibility of the provincial government, typically through a dedicated agency. For example, in Québec, oversight of the CPA profession is the responsibility of the Office des professions, which oversees all recognized professions such as lawyers, dentists and medical doctors. The Office appoints members to the board of the Ordre des CPA.[163]

Provincial CPA institutes typically have a department or unit responsible for following up on and investigating complaints against their members. For example, the CPA Institute of Ontario has a Vice-President of Standards Enforcement who oversees inspections, professional conduct, investigations and enforcement.[164] The Ordre des CPA has a Vice-President of Inspection and Professional Practice as well as a trustee whose role is to receive complaints from the public and launch disciplinary measures against members who have failed to respect the CPA Act and the professional code of conduct.

If matters against a member are deemed serious enough, a provincial CPA institute may forward the file to civil or criminal authorities for prosecution. The extent of the power held by the disciplinary bodies of provincial institutes varies according to each province's legislation and legal precedent. Legal decisions regarding the Livent case in Ontario are telling in this regard. In 2007, three partners who were directly involved in the Livent audit (two of whom have since retired) were found guilty of multiple counts of professional misconduct by the discipline committee of the Institute of Chartered Accountants. Their audit firm, one of the four largest international firms, had issued a clean audit opinion on Livent's 1997 financial statements, a few months before its bankruptcy. The charges were subsequently upheld by the appeals committee of the Institute of Chartered Accountants in 2009. More specifically, all three partners were found guilty of professional misconduct for two instances of failing to ensure that Livent's financial statements were

[163] While all members of a provincial CPA institute are bound by their institute's code of professional conduct, in practice only those members who offer accounting services to the public are monitored for their compliance with appropriate laws, regulations and standards.

[164] CPA of Ontario, 2014, Annual report 2014, available at http://www.cpaontario.ca/member/agm/1011page18573.pdf (accessed 4 January 2016).

in accordance with GAAPs related to the booking of certain revenues. Two of the partners were also convicted of a third breach of GAAPs, along with five instances of failing to perform an audit in accordance with generally accepted auditing standards. Following the disciplinary body decision, all three partners sought to have it overturned and launched legal proceedings against the Institute of Chartered Accountants. In 2010, in a surprise decision that undermined the way in which the accounting profession disciplines its members and was seen as a major strike against the Institute of Chartered Accountants, an Ontario divisional court overturned most of the professional misconduct charges against the three partners. One observer noted that it was an interesting decision and that the "court held that it may be the case the accountants' conclusions were wrong, but it doesn't necessarily mean they had an error in judgement such that it would be considered a breach of their professional obligations".[165]

The legal proceedings were not over, however. The Institute of Chartered Accountants sought a ruling from the Court of Appeal for Ontario to suspend the application of the lower court's decision, which it obtained. The Institute of Chartered Accountants then appealed the decision. In 2011, the Court of Appeal reversed the lower court's decision, and reinstated all outstanding professional misconduct charges and costs imposed by the Institute of Chartered Accountants against the three partners. The panels for both the hearing and the appeal included four chartered accountants. In its decision, the Court of Appeal stated that "this case is important to the Institute of Chartered Accountants and the self-regulation of the accounting profession" and the "hearing was the longest in the history of the institute".[166] The Court thus underlined the importance of self-regulation in professions. Soon after the decision, the Institute of Chartered Accountants published a notice naming the three partners and stating that they "were found guilty of contravening the Institute's rules of professional conduct for failure to perform an audit in accordance with generally accepted standards of the profession [and were] ordered by the discipline committee to pay a fine and charged costs".[167]

3. Regulatory resources

Assessments of the resources devoted to MCE of professional rules and codes of conduct for practicing accountants are tentative, as the level of disclosure varies by provincial institute. For example, the Ordre des CPA, in the year ended 31 March 2014, spent Can$7.35 million on supervision of the profession (about 13 per cent of its overall operating budget). Around 46 per cent of this amount (Can$3.4 million) was for complaint reviews, disciplinary actions and legal affairs, and the majority of the rest for professional inspections and licensing.[168] Once the merger of Canada's accounting professions has been completed, Québec will have approximately 25 per cent of Canada's CPAs, which gives some indication as to the overall magnitude of resources spent in the rest of Canada. In comparison, the CPA Institute of Alberta spent Can$3.6 million on its public trust mission in 2014, or approximately 29 per cent of its overall operating budget. Close to 50 per cent of that amount (14 per cent of overall budget) was for complaint reviews and discipline.[169] Comparable figures for Ontario, the largest province by population, are not available.

4. Process for monitoring and enforcement

The provincial professional accounting institutes have two mechanisms to supervise their members, as follows: a professional inspection service that oversees all members active in public accounting; and, through their trustee departments, the receipt and processing of complaints and allegations filed by the public against members. In practice, professional inspections of publicly listed clients are mostly done at the CPAB

[165] *The Bottom Line*, 2010, Court shoots holes in Institute of Chartered Accountants Livent decision, available at http://www.thebottomlinenews.ca/articles/447 (accessed 4 January 2016).

[166] Court of Appeal of Ontario, 2011, Barrington et al. v. Institute of Chartered Accountants, available at http://files.slaw.ca/cases/barrington.pdf (accessed 4 January 2016).

[167] *Financial Post*, 2012, Continuing collateral damage from Livent, 3 February, available at http://business.financialpost.com/news/fp-street/continuing-collateral-damage-from-livent (accessed 4 January 2016).

[168] Ordre des CPA du Québec, 2014, 2013–2014 annual report, available at http://cpaquebec.ca/~/media/docs/public-medias/salle-presse/rapports-annuels/rapport-annuel-2013-2014-en.pdf (accessed 4 January 2016).

[169] CPA of Alberta, 2014, Annual report 2014, available at http://www.albertacas.ca/resources/publications/general_interest/AnnualReport.aspx (accessed 4 January 2016).

level, with institutes dealing with files deemed less risky. However, trustees are responsible for disciplining members for actions deemed inconsistent with the rules and codes of conduct, irrespective of whether they arise from audits of publicly listed clients.

5. Trends

As most of the disciplinary proceedings initiated by provincial institutes relate to matters outside of financial reporting by publicly listed entities, it is difficult to ascertain whether there are any trends in enforcement actions on this matter. Moreover, comparability across provinces is an issue, as what constitutes a violation of professional accounting laws or regulations, and the resulting disclosure, varies across provinces. Finally, the staggered mergers of the three professional accounting organizations make any year-to-year comparisons tentative at best, as laws and disclosures in prior years differed across the three organizations. The only reliable and comparable data currently available is from the Ordre des CPA, which received 940 new complaints against its members in 2014 (502 in 2013), with 51 cases referred to disciplinary hearings. These cases involved 217 charges on issues such as breaches of independence and conflicts of interest; associations with misleading statements, signatures of convenience or fraud; lack of integrity and objectivity; non-compliance with standards; breaches of the obligation to ensure that partners comply with the code; and obstruction of a trustee's work.

E. CONCLUSION

Perhaps the best way to describe MCE of financial reporting standards in Canadian securities markets is to state that it is multidimensional. On one level, while the enactment of financial reporting standards is through a national body, AcSB, MCE of such standards is essentially done at a provincial level, as oversight of securities markets is a provincial responsibility. In contrast, most of the other countries with sizeable capital markets have a national regulator, for example SEC or the Autorité des marchés financiers in France. While such fragmentation may appear to undermine the effectiveness of regulatory oversight of financial markets, it must be noted that the situation in other countries is far from being as streamlined as it appears. For example, in the United States, many securities markets cases are actually initiated and prosecuted by a state attorney general, not by SEC. The difficulties of coordinating action between provinces may thus to some extent be compensated for by a strong presence on the ground across the country.

On another level, the legal dimension of enforcement varies according to the seriousness of the charges, as criminal law is under the responsibility of the federal Government while penal and civil cases are under provincial jurisdiction. For example, investigations of financial reporting fraud, a criminal offense, require the involvement of federal authorities such as the Royal Canadian Mounted Police. The fact that Québec relies on code law, in the continental European tradition, while the rest of Canada relies on common law, increases the complexity. Similar cases brought in Québec and in another province may therefore not have the same outcome, irrespective of the evidence.

On yet another level, MCE is also divided between self-regulatory organizations, for example the provincial CPA institutes for their individual members, and securities regulators for listed corporations and their officers.

Finally, another level of difference is between auditing and accounting. MCE of auditing standards is primarily under the responsibility of CPAB, which is essentially controlled and financed by provincial securities regulators and which oversees the audit firms involved with publicly listed firms. In contrast, responsibility for MCE of accounting standards rests primarily with provincial securities regulators, who directly oversee the publicly listed firms registered in their provinces.

Another unique dimension of the Canadian securities markets is the importance of SEC in MCE of accounting standards. Canadian firms represent the largest group of foreign private issuers registered with SEC, far above those of any other country. Moreover, such cross-listed firms are often large and, together, represent a significant proportion of Canada's stock market capitalization and, ultimately, Canadian investor portfolios. Such dual oversight is certainly reassuring to investors and may explain the approach of Canadian securities regulators, which involves a greater emphasis on monitoring and less on enforcement, while SEC has the opposite strategy of devoting more resources to enforcement and less to monitoring.

The Canadian regulatory landscape with regard to securities markets is bound to further evolve in the near future as the federal Government pursues its initiative of establishing a national securities commission. Several provinces, including British Columbia and Ontario, have joined the federal Government in this regard, with an emphasis on exploiting the federal Government's constitutional role and responsibilities with regard to systemic risks to Canadian financial markets. Further court challenges are likely to arise from the federal Government's initiative. However, experience in the United States shows that, in a federal country, even with a national securities regulator with strong MCE powers, there is still a purpose and role in this regard for provincial regulators.

APPENDIX IV.1 DEVELOPMENT AND ENACTMENT OF FINANCIAL REPORTING STANDARDS[167]

The initial adoption of IFRS by AcSB involved a multi-year strategic planning and transition process with extensive consultation across Canada. Several options were considered, such as keeping made-in-Canada accounting standards, adopting United States GAAPs and adopting IFRS. Ultimately, it was decided to adopt IFRS for all publicly accountable enterprises, which resulted in the issuance of three omnibus exposure drafts in 2008–2009 of all of the then-issued IFRS. The decision was based on several factors. First, at the time, the International Accounting Standards Board and United States Financial Accounting Standards Board had identified several issues for which they were willing to engage in joint projects, thus providing some indication that substantive differences between the two sets of standards were being reduced, a source of comfort for Canadian issuers. Second, there was a public expression of interest at the time by the chair of SEC for accounting standards convergence. Third, as they are principles-based, IFRS were closer in spirit to current Canadian GAAPs while the United States GAAPs were deemed more rule-oriented and excessively complex for the vast majority of Canadian issuers, many of which are relatively small in size and whose shares are exclusively traded on Canadian markets. Fourth, while Canada may expect to have some influence in the development of IFRS through representation on and interactions with the International Accounting Standards Board, it was deemed unlikely that it would be able to achieve such influence with the Financial Accounting Standards Board, which is under the direct authority of SEC.

While IFRS now constitute Canadian GAAPs, AcSB is still the gatekeeper for Canada's financial reporting standards. Accordingly, the Board reviews changes to the constitution of the International Accounting Standards Board and closely monitors its governance and due process, including commenting on proposals for improvements. AcSB monitors ongoing application of due process in each project of the International Accounting Standards Board and IFRS Interpretations Committee and participates in related processes. Furthermore, AcSB encourages its stakeholders to participate in the International Accounting Standards Board's process for developing new and amended standards, and facilitates direct contact with the latter's representatives through outreach activities. Through these activities, AcSB gathers evidence of the quality of the way in which the International Accounting Standards Board develops standards and, accordingly, the extent to which AcSB may rely on the standards being of the highest quality.

Once the International Accounting Standards Board has issued an exposure draft for a new standard or modifications to existing IFRS, AcSB issues its own wraparound exposure draft (a similar process is used for draft interpretations of the IFRS Interpretations Committee), which directs Canadian stakeholders to comment directly to the International Accounting Standards Board but also solicits stakeholder input on the following question: "The proposed standard has been developed by the International Accounting Standards Board for application by entities around the world. Assuming the exposure draft proposals are approved by the International Accounting Standards Board, do you believe that there are aspects of the proposed standard that make some or all of it inappropriate for Canadian entities, even though it is appropriate for entities in the rest of the world? If so, please specify which aspects and what circumstances make the accounting requirements proposed in the exposure draft inappropriate for Canadian entities."[171]

As soon as possible following the International Accounting Standards Board's approval of a new or amended standard, AcSB reviews the final steps in the former's due process, including the review by the IFRS Due Process Oversight Committee. It also considers the responses to its wraparound exposure draft. AcSB then approves the new material by written ballot, translates the text into French and publishes the English and French texts in the CPA Canada Handbook – Accounting.

[170] AcSB, 2014, Due process handbook, available at http://www.frascanada.ca/accounting-standards-board/what-we-do/due-process/item67162.pdf (accessed 4 January 2016); International Accounting Standards Board, 2015, IFRS application around the world – Jurisdictional profile: Canada profile, available at http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Canada-IFRS-Profile.pdf (accessed 4 January 2016).

[171] International Accounting Standards Board, 2015.

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