UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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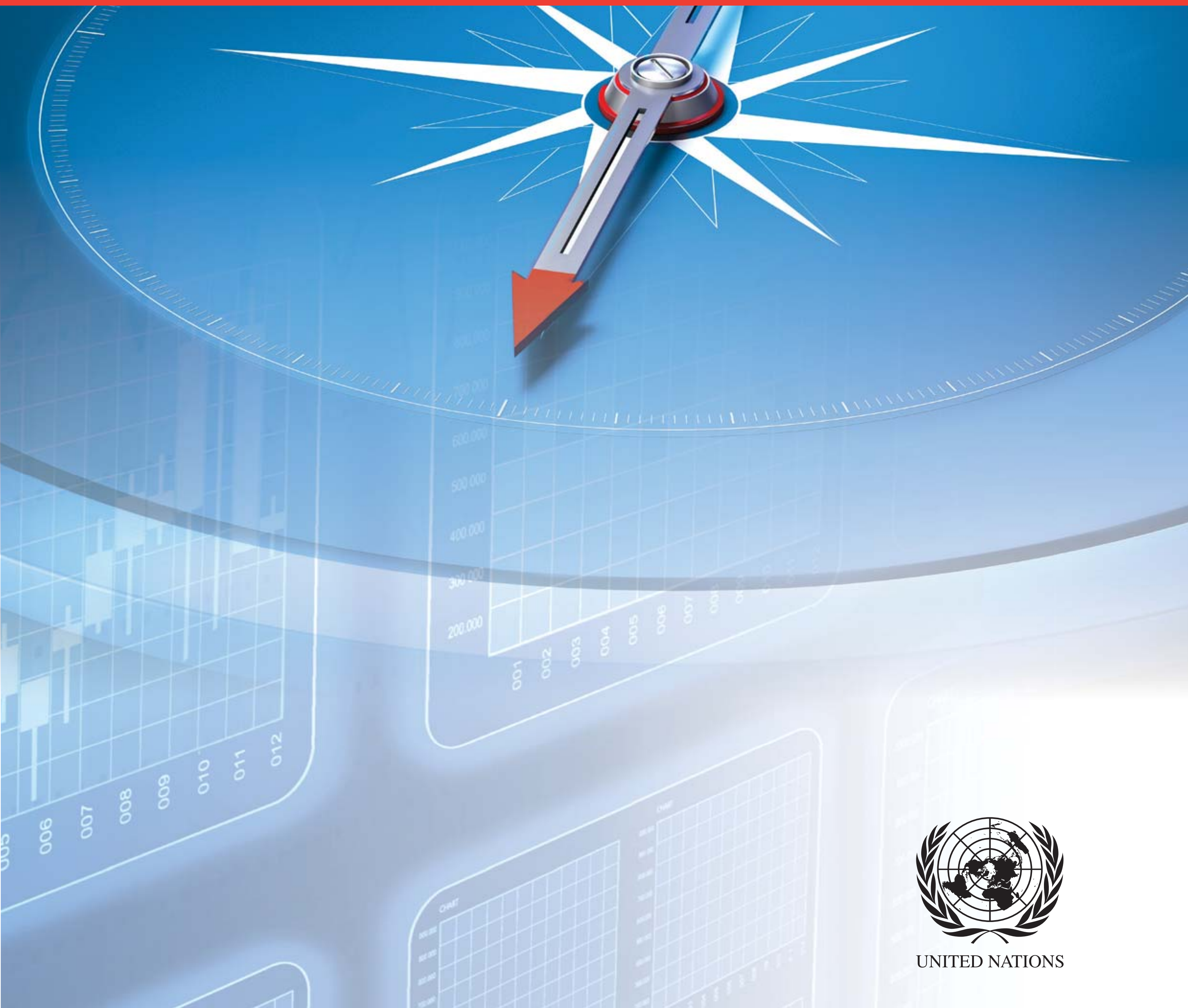
Monitoring of Compliance and Enforcement for High-quality Corporate Reporting:

Guidance on Good Practices



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CONTENTS

Acknowledgements v

Main abbreviations vi

I. Introduction and background 1

II. Conceptual framework for the MCE system 5

2.1 Definitions 5
2.2 Objective and scope 5
2.3 Key guiding principles 6
2.4 Core elements 10

III. MCE requirements for corporate reporting 19

3.1. Definition 19
3.2. Scope and objectives 19
3.3. Institutional arrangements 20
3.4. Activities 22
3.5. Monitoring arrangements and impact assessment 25

IV. MCE requirements for auditing and quality assurance 27

4.1. Definition 27
4.2. Scope and objectives 27
4.3. Key considerations 28
4.4. Institutional setting and activities 33
4.5. Monitoring arrangements and impact assessment 37

V. MCE requirements for professional accountants 39

5.1. Definition 39
5.2. Scope and objectives 39
5.3. Institutional arrangements 40
5.4. Benchmarks 42
5.5 Monitoring arrangements and impact assessment 43

Annex I. International standards 45

A. Accounting standards 45
B. Environmental, social and governance disclosure standards and guidelines 45
C. Auditing and assurance standards 46
D. Professional accountant requirements 47

References 49

NOTE

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MAIN ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
ACRA	Accounting and Corporate Regulatory Authority (Singapore)
ADT	Accounting Development Tool
APAK	Auditor Oversight Commission
AQR	audit quality review
ASIC	Australian Securities and Investments Commission
CALDB	Companies Auditors and Liquidators Disciplinary Board
CPAB	Canadian Public Accountability Board
CPD	continuing professional development
COSO	Committee of Sponsoring Organizations of the Treadway Commission
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority (United Kingdom)
FEE	Federation of European Accountants
FRC	Financial Reporting Council (United Kingdom)
FREP	Financial Reporting Enforcement Panel (Germany)
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants of England and Wales
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
ISO	International Organization for Standardization
ISQC	International Standard on Quality Control
MCE	monitoring of compliance and enforcement
PAAB	Public Accountants and Auditors Act (Zimbabwe)
PAO	professional accountancy organization
OCA	Office of the Chief Accountant
PCAOB	Public Company Accounting Oversight Board
PIOB	Public Interest Oversight Board
PIE	public interest entity
ROSC	Report on Observance of Standards and Codes
RQB	recognized qualifying body
RSB	recognized supervisory body
SME	small and medium-sized enterprise
SMO	Statement of Membership Obligation
WPK	Chamber of Public Accountants

I. INTRODUCTION AND BACKGROUND

1. High-quality reporting enhances the investment climate and fosters competitive enterprise development. In the context of the 2030 Agenda for Sustainable Development, a sound corporate reporting infrastructure contributes to the realization of the Sustainable Development Goals. In particular, Goal 16 seeks to promote just, peaceful and inclusive societies, with targets on the promotion of the rule of law, the reduction of corruption and bribery, and the development of effective, accountable and transparent institutions. A series of international standards and benchmarks related to corporate reporting has emerged over the last two decades. These standards have continued to support the path to improved corporate governance, efficient capital markets and sustainable growth.

2. High-quality corporate reporting is also a key tool in protecting the public interest; thus global standards and codes should have the public interest in mind. In this respect, the Public Interest Oversight Board (PIOB) plays an essential role.[1] The UNCTAD Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been contributing to the global efforts aimed at improving quality of corporate reporting, including by publishing the Accounting Development Tool.

3. The benefits of high-quality standards can only be attained if these standards are properly implemented. To achieve this objective, a number of key elements of a robust accounting and reporting infrastructure need to be in place. One such essential element is an effective system of monitoring of compliance and enforcement (MCE) of the legal and regulatory requirements of corporate reporting.

4. Building a sound MCE system remains a challenge in many countries, particularly in developing countries and countries with economies in transition, due to the complexity of such a system, its relative novelty and significant interdependence with the many different institutional and legal settings of national jurisdictions. Existing national regulatory bodies frequently lack the mandates, resources, methodologies and technical capacity required to monitor and enforce corporate reporting standards and codes, including accounting and auditing requirements.

5. Raising awareness of good practices and developing guidance on the implementation of international requirements in this area could contribute to addressing a growing demand on building and strengthening the MCE system. In recent years, a number of important pronouncements have been issued. This includes the guidance on the cooperation between competent authorities within the European Union (by the European Group of Auditors' Oversight Bodies);[2] the policy position on the regulation of the accountancy profession[3] and the Statements of Membership Obligations (SMOs)[4] issued by the International Federation of Accountants (IFAC); the Core Principles for Independent Audit Regulators issued by the International Forum of Independent Audit Regulators – IFIAR;[5] the Objectives and Principles of Securities Regulation from the International Organization of Securities Commissions (IOSCO);[6] the Guidelines on the Enforcement of Financial

[1] For an overview of the Board's work, see Public Interest Oversight Board, 2015, *Standard setting in the Public Interest: A Description of the model*, available at http://www.ifac.org/system/files/uploads/IFAC/Standard-Setting-in-the-Public-Interest-A-Description-of-the-Model-PIOB-Sept-2015.pdf (accessed 7 February 2017).

[2] European Group of Auditors' Oversight Bodies, 2009, *Guidance Paper on the Cooperation Between Competent Authorities within the EU*, available at http://ec.europa.eu/internal_market/auditing/docs/relations/08122009_egaob_report_en.pdf (accessed 7 February 2017).

[3] IFAC, 2011a, *Regulation of the Accountancy Profession*, available at https://www.ifac.org/system/files/publications/files/PPP1-Regulation-of-the-Accountancy-Profession.pdf (accessed 7 February 2017).

[4] IFAC, 2012, *Statements of Membership Obligations*, available at https://www.ifac.org/system/files/publications/files/Statements-of-Membership-Obligations-1-7-Revised.pdf (accessed 7 February 2017).

[5] IFIAR, Core Principles for Independent Audit Regulators, available at https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 7 February 2017).

[6] IOSCO, 2010a, Objectives and Principles of Securities Regulation, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf (accessed 7 February 2017).

Information of the European Securities and Markets Authority (ESMA) of July 2014[7] (which replaced the previous two standards on the Enforcement of financial information and on Coordination of Enforcement Activities, by the Committee of European Securities Regulators issued in April 2003[8] and April 2004[9] respectively); and others. However, there is a need to address the issue in a comprehensive manner to assist developing countries and countries with economies in transition in building or improving their infrastructure for high quality corporate reporting.

6. This document was prepared by the UNCTAD secretariat at the request of member States at the thirty-first session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) that took place in October 2014. It takes into consideration the feedback and results of the application of the UNCTAD-ISAR Accounting Development Tool (ADT)[10] in a number of countries, which indicated that further efforts are needed in many cases to support countries in building an MCE system. It is also based on the ISAR discussions on this matter and five country case studies covering Australia, Belgium, Canada, Germany and the United Kingdom prepared for these discussions. This guidance document was prepared in collaboration with the members of the Consultative Group convened by UNCTAD to discuss and enhance the initial draft document prepared by the UNCTAD secretariat. Significant input was provided by the International Federation of Accountants (IFAC) to chapter V on monitoring of compliance and enforcement for professional accountants.

7. The objective of this guidance document is to provide policymakers with references to developments and good practices that they could consider in designing, developing and operationalizing their national MCE systems. It could also provide useful information to other stakeholders for their understanding of the main aspects and challenges of MCE-related issues and how they can contribute to its building and functioning.

8. The document proposes a conceptual framework to underpin the MCE system, addressing issues such as key definitions, objective and scope; key principles on which the system might be based; and core elements. These issues are further elaborated with regard to specific areas of MCE, such as corporate reporting requirements, audit function and professional accountants. It is built on international pronouncements and existing good practices and benchmarks to which references are provided. Examples of good national and regional practices are presented in dedicated boxes throughout the document.

9. It is not intended to be a "one-size-fits-all" document, and the list of these references is by no means exhaustive. Similarly, MCE systems do not need to follow one single approach, but rather be adapted to the local institutional context. The information contained in this document, including examples of practices, need to be carefully examined by decision makers to assess their applicability in a specific national environment and whether/how it could be adapted to the particular legal and regulatory requirements of their country, for the benefit of high-quality corporate reporting to facilitate investment and sustainable development.

10. Chapter II of this guidance lays down the main aspects of an effective MCE system, encompassing key principles, and its core elements, including legal requirements, institutional arrangements, governance mechanisms, staffing, funding, and monitoring and impact assessment.

[7] ESMA, 2014, *ESMA Guidelines on enforcement of financial information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf (accessed 7 February 2017).

[8] ESMA, 2003, *Standard No. 1 on Financial Information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/03_073.pdf (accessed 7 February 2017).

[9] ESMA, 2004, *Standard No.2 on Financial Information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/03_317c.pdf (accessed 7 February 2017).

[10] The UNCTAD-ISAR Accounting Development Tool is a quantitative measurement tool designed to assess the level of development of accounting infrastructure for high-quality and internationally comparable corporate reporting. It consists of a capacity-building framework and a set of indicators to identify gaps and priorities for further improvements and capacity-building. Its objective is to assist policymakers and other stakeholders in their efforts to strengthen their accounting and reporting infrastructures for high-quality reporting meeting requirements of international standards and good practices. MCE is one of key aspects of the ADT. For more details on the ADT, see UNCTAD/DIAE/ED/2013/7.

11. The guidance then focuses on specific aspects of the three key areas of the MCE system on corporate reporting, which are covered in chapters III, IV and V, respectively: corporate reporting, auditing requirements and professional requirements.

II. CONCEPTUAL FRAMEWORK FOR THE MCE SYSTEM

12. To build an effective MCE system it is important to address the following issues:

    (a) Establish key definitions;

    (b) Define the objective and scope;

    (c) Establish the key principles on which the system will be based;

    (d) Establish core elements, including activities and methodologies;

    (e) Ensure availability of competent staff ;

    (f) Make available reliable funding sources;

    (g) Build monitoring arrangements and impact assessment mechanisms.

2.1 DEFINITIONS

13. To build a national MCE system, it is necessary to define each of the components: monitoring, compliance and enforcement.

14. Compliance normally is understood as the adherence to laws, regulations and rules. Monitoring of compliance refers to the supervision and investigation conducted to verify compliance; it seeks to encourage the right behaviours to promote compliance. Enforcement refers to the action of obliging adherence to the respective requirements and the implementation of sanctions when violations are found. It is a disciplinary function that seeks to ensure that there are consequences to the violation of rules, involving a set of tools used to punish breaches of laws and regulations, and to deter future violations. In some circumstances, violations of rules may also lead to civil damages and criminal sanctions.

15. Enforcement could be interpreted in a narrow way, such as a disciplinary function. It could also be understood in a broader manner, including compliance in the context of the enforcement system. In this case, enforcement also considers the means by which assistance and incentives are provided to encourage greater compliance.

16. For example, IOSCO, in its principles 10, 11 and 12 of securities regulation, establishes that enforcement should be interpreted broadly enough to encompass powers of surveillance, inspection and 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.[11]

2.2 OBJECTIVE AND SCOPE

17. When building an effective MCE system, it is important to define its objective and scope.

18. Normally, the overall objective of the MCE system is to strengthen the infrastructure for high-quality and internationally comparable corporate reporting, as well as to enhance compliance with national and international regulations.[12] The scope of such a system could cover different elements of the reporting chain and need to be clearly defined.

19. An MCE system might detect failures in the implementation of standards. Some of those failures will be due to weaknesses in the standards, such as a lack of clarity or implementation guidance. The detection of areas of possible improvements to the standards could be a positive outcome of a high-quality MCE system.

20. Several issues may arise in defining the scope of an MCE system. For example, consideration need to be given with regard to which elements in a reporting chain would fall under the scope of such a system. That is, the MCE system may relate to securities market regulation and compliance with company law and stock exchange listing rules; to compliance with accounting standards and legal requirements related to companies' and other entities' financial and non-financial reporting; to audit regulation; or to the regulatory requirements for professional accountants.

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[11] IOSCO, 2013, Methodology for Assessing Implementation of the International Organization of Securities Commissions Objectives and Principles of Securities Regulation, available at http://www.ebrd.com/downloads/legal/securities/IOSCOPD155.pdf (accessed 7 February 2017).

[12] UNCTAD, 2013a, *Accounting Development Tool: Building Accounting for Development*, United Nations publication, UNCTAD/DIAE/ED/2013/7.

21. The ESMA guidelines state that the objective of enforcement of reporting requirements 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 contribute to financial stability by avoiding regulatory arbitrage, increasing supervisory convergence in a region and fostering investor confidence. Other relevant objectives for enforcement include the development of efficient capital markets and the promotion of sustainable growth.

22. The ESMA Securities and Markets Stakeholder Group also considered that the objective of enforcement should address not only investors' but also issuers' needs. Some members of this Group suggested extending the objective to include a broader ecology of high-quality reporting, which includes education standards and support for preparers of financial information, as qualified human capital is one of the key assets of an effective system of monitoring of compliance and enforcement.[13]

23. According to the European Federation of Accountants (FEE), the key features of the institutional setting that have a bearing on the quality of financial reporting include corporate governance, statutory audit, the institutional oversight system, courts, public and press sanctions. With regard to enforcement, it outlines six levels:

(a) Self-enforcement: preparation of financial statements;

(b) Statutory audit of financial statements;

(c) Approval of financial statements;

(d) Institutional oversight system;

(e) Court: sanctions/complaints;

(f) Public and press reactions.[14]

2.3 KEY GUIDING PRINCIPLES

24. It is important to define key principles on which the MCE system will be founded. These may include:

(a) Public interest focus;

(b) Independence;

(c) Transparency and accountability;

(d) Confidentiality;

(e) Proportionality;

(f) Cooperation and coordination.

2.3.1 Public interest focus

25. Protecting the public interest has gained prominence in the standard-setting process, as well as regulation and enforcement of their implementation. It is therefore very important for the MCE system to be designed in a way that it is able to serve the public interest. One of the key functions of the International Public Oversight Board is ensuring that international standards and codes, as well as related documents published by different boards such as the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB), serve the public interest. Thus, MCE systems can further enhance the public interest by supporting the consistent implementation of such standards and codes.

2.3.2 Independence

26. Independence allows regulators and supervisory entities to conduct their activities in an objective and fair manner, free from undue influence from other stakeholders.

27. The core principles of IFIAR define independence as the ability to undertake regulatory activity and make and enforce decisions without external interference by those regulated. For example, IFIAR principle 2 mandates that "the audit regulator should be operationally independent from external political interference and from commercial, or other sectoral interests, in the exercise of its functions and powers, including

[13] ESMA, 2014, *Guidelines on enforcement of financial information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf (accessed 7 February 2017).

[14] FEE, 2001, *Enforcement mechanisms in Europe: A preliminary investigation of oversight systems*, available at http://www.iasplus.com/en/binary/resource/fee0104.pdf (accessed 7 February 2017).

not being controlled in its governance by audit practitioners". Principle 5 further notes that audit regulators should have arrangements in place to ensure that inspectors are independent of the profession.[15]

28. The ESMA guidelines state that enforcers should have adequate independence from Government, issuers and auditors, other market participants and regulated market operators.[16] For example, the European Commission states in this regard that a system of public oversight should be governed by non-practitioners who are knowledgeable in areas relevant to statutory audits.[17]This brings into consideration the relationship between independence and accountability, including a mechanism for appeals.

29. The IESBA Code of Ethics is applied as a benchmark in many jurisdictions. IESBA's definition of independence elaborates on the concept, stating that it comprises of:[18]

(a) Independence of mind

"The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism."

(b) Independence in appearance

"The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised."

2.3.3 Transparency and accountability

30. Regulators' procedures and resolutions need to be transparent and, in many cases, this means that information must be made public. A need for building transparent and accountable institutions is reinforced by the 2030 Agenda for Sustainable Development and explicitly highlighted as a target in one of its Sustainable Development Goals (Goal 16.6).

31. In this regard, IFIAR principle 4 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.[19] In addition, it states that transparency should include the publication of annual work plans and activity reports, including the selection criteria for inspections, either in the aggregate or on an individual basis.

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

[15] IFIAR, *Core Principles for Independent Audit Regulators*, available at https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf

[16] ESMA, 2014, *Guidelines on enforcement of financial information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf (accessed 7 February 2017).

[17] European Parliament, 2016, *Directive 2006/43/EC of the European Parliament and of the Council of 17 may 2006*, available at http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32006L0043 (accessed 7 February 2017).

[18] IESBA, 2016, *Section 290.6 of the Code of Ethics*, available at http://www.ethicsboard.org/iesba-code (accessed 7 February 2017).

[19] IFIAR, *Core Principles for Independent Audit Regulators*, available at https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 7 February 2017).

Box 1. Examples of disclosure policies

In Germany, whenever erroneous accounting is established, the accounting regulator requires firms to disclose these findings in a dedicated press release, published on 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 regulator requires firms to refrain from comments or additions. The publication of an error finding automatically triggers an investigation of the auditor by the auditing oversight authorities.

The United Kingdom has a sliding scale approach that applies from silent correction to announcing the fact that the regulator has intervened. It is followed by a press notice when the next year's accounts are corrected and finalized.

2.3.4 Confidentiality

33. Regulators need to observe confidentiality when handling a case and reviewing information.

34. IOSCO principles 4 and 5 also stress the importance of consistent regulatory processes and confidentiality.

35. IFIAR states that audit regulators should have prohibitions in place against conflicts of interest by its governing body and staff, and that they should ensure that confidential information is protected. Various examples of confidentiality policies are provided in subsequent chapters of this guidance.

2.3.5 Proportionality

36. Some disclosure systems are designed to serve the reporting needs of entities in a proportionate manner. For example, while public interest entities are required to apply International Financial Reporting Standards (IFRS), SMEs use the IFRS for SMEs. Similarly, MCE systems need to apply a differential compliance and enforcement requirements commensurate with the economic importance of the entity they regulate. Proportionality is one of the general principles in European Union regulation.[20] This principle indicates that regulatory action should be limited to what is necessary in order to achieve the objectives of European Union law. As such, the action undertaken as part of an MCE system should be proportional with the pursued aims and the potential regulatory gaps identified during the oversight exercise.

[20] EUR-Lex, *Proportionality principle,* available at http://eur-lex.europa.eu/summary/glossary/proportionality.html (accessed 7 February 2017).

2.3.6 Cooperation and coordination

37. Cooperation and coordination are critical to ensure consistent regulatory requirements for the same type of conduct and product, coherence of regulation among different sectors, and exchange of information between competent authorities. It includes cooperation between domestic authorities and their foreign counterparts. It also includes coordination between different areas of a MCE system, such as corporate reporting, audit function and the accounting profession.

38. IFIAR principle 7 states that audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. IFIAR conducts cooperation efforts and has published a report summarizing the results of a global survey on the inspection of audit firms.[21] The European Group 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.[22]

[21] IFIAR, 2016, *Report on 2015 survey of inspection findings*, available at https://www.ifiar.org/IFIAR/media/Documents/General/About%20Us/IFIAR-2015-Survey-of-Inspection-Findings.pdf (accessed 7 February 2017).

[22] European Group of Auditors' Oversight Bodies (2009), *Guidance paper on the cooperation between competent authorities within the EU*, available at http://ec.europa.eu/internal_market/auditing/docs/relations/08122009_egaob_report_en.pdf (accessed 7 February 2017).

Box 2. Examples of good practices on cooperation

An example of cooperation and regional integration is the Association of Southeast Asian Nations Audit Regulators Group, an informal cooperation group created in 2011 by the Accounting and Corporate Regulatory Authority of Singapore, together with the independent audit regulators of Malaysia and Thailand. It holds periodic meetings with the four largest regional firms to discuss audit quality matters.

An example of cooperation between national key stakeholders is described in the annual report of Germany's Financial Reporting Enforcement Panel (FREP). As an instrument of prevention, the FREP Presidential Board held discussions with the chairs of the management boards or managing

Box 2. Examples of good practices on cooperation

directors of the five largest German audit firms, and afterwards a similar dialogue took place with all medium-sized audit firms that are auditing publicly listed companies. These discussions aimed to share experiences regarding the errors found by FREP in financial statements of companies audited by the audit firms.

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.

In some cases, the MCE system may need to address procedures on cooperation with the overseas auditors.

In the United States, the Public Company Accounting Oversight Board (PCAOB) applies the same regime to overseas auditors of Securities and Exchange Commission registrants and domestic registrants.

The European Union, on the other hand, has an equivalent audit regime as part of its regulation of third-country auditors (those who audit non-European Union companies which are listed in the European Union), by which it grants certain countries approval to conduct their own audit oversight functions after having evaluated their enforcement systems. The European Union allows the exchange of work papers and cooperation with an overseas regulator if this cooperation is reciprocal; the United States requires either for the parent auditor to procure cooperation of the subsidiary auditor or registration of the subsidiary auditor.

In Canada, while foreign firms are subject to the oversight of the Canadian Public Accountability Board (CPAB), and overseas firms or individuals are subject to the same requirements as local member firms/individuals, CPAB may consider entering into reciprocal arrangements with independent oversight bodies in other jurisdictions.

Some countries have bilateral agreements to share information. For example, the United States and Canada agreed that PCAOB would rely on the work of the Canadian oversight body for cross-listed firms.

In Australia, the Institute of Charted Accountants and the Securities and the Investment Commission complement each other and make sure that they do not overlap and that they do not inspect the same firms.

In some countries, information is shared more broadly with other interested parties. For example:

- Under the European Union Audit Regulation, auditors must share concerns about banks and insurers with the prudential regulators of those bodies;
- In the United Kingdom, the tax authority has the right to share information with the Conduct Committee as the accounting enforcement body (for example, if they believe that inappropriate accounting may have led to a miscalculated tax liability). The auditor, the corporate reporting inspection and the enforcement teams at the Financial Reporting Council regularly share information with each other.

Sources: Accra, 2016; CPAB, 2017; FREP, 2016.

2.3.7 Other guiding aspects

39. In addition to the six guiding principles mentioned above, additional factors may be taken into consideration in defining the bases of an effective MCE system, including:

(a) Stakeholder dialogue within the MCE system;

(b) Risk-based approach to monitoring;

(c) Consistency in enforcement actions.

2.4 CORE ELEMENTS

40. In establishing an effective MCE system, the following core elements need to be considered:

(a) Legal requirements including key standards, codes and benchmarks, as well as enforcement powers;

(b) Institutional arrangements;

(c) Good governance mechanisms;

(d) Range of preventive, discipline and appeal tools, activities and methodologies;

(e) Competent staff;

(f) Funding models;

(g) Monitoring arrangements and impact assessment mechanisms.

2.4.1 Legal requirements

41. A legal framework of a country constitutes a key element of an effective MCE system. It provides the foundations for national governments' regulatory requirements, enforcement of checks and balances, or the hiring of qualified staff. Such elements may be incorporated as part of national law; they may draw on international standards and codes on accounting, audit and assurance, or professional qualification requirements. It is very important that there be a clear understanding of standards and codes used for compliance and enforcement purposes. In this respect, the appropriate preconditions, such as the legal framework that defines the principles of economic regulation and economic activity, are necessary.

42. To assist in the building of a regulatory framework that will allow systems to meet international requirements for high-quality corporate reporting, a wide range of international standards issued by international bodies is available, as well as other internationally accepted good practices and benchmarks. It is important to have relevant international or national standards in place within the MCE framework, with appropriate guidance on their implementation. Annex I provides references to relevant international standards in accounting (including environmental and social and governance accounting), auditing and assurance, and qualifications for corporate reporting professionals.

2.4.2 Institutional arrangements

43. An effective MCE system should have a solid institutional base, including its organizational structure, responsibilities and tools. Its functions should be carried out by the competent authorities with clear responsibilities and comprehensive investigation and enforcement powers established by law. These features commonly differ between countries.

44. While external auditors have a role in providing assurance about the quality of financial information, other entities such as a stock exchange or government body may play a role in promoting or monitoring the accounting information provided in capital markets.[23] This also means promoting compliance with the rules regulating the behaviour of market participants.[24]

45. Responsibility for all aspects of MCE does not have to be given to a single body. There are several effective models, including models in which responsibilities are shared with self-regulatory organizations. These are defined as organizations that exercise some direct oversight responsibility for their respective areas of competence. However, a clear division of responsibilities between major players within a reporting chain, such as enforcers, preparers and auditors, is critical; as well as cooperation and coordination between them, to avoid inconsistencies and duplication.

[23] Frost et al., 2006, Stock exchange disclosure and market liquidity: An analysis of 50 international exchanges, *Journal of Accounting Research*, 44(3):437–483.

[24] ESMA, 2003, *Standard No. 1 on Financial Information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/03_073.pdf (accessed 7 February 2017).

46. In this regard, one of the issues raised in the consultation process preceding the finalization of the ESMA guidelines was the importance of ensuring that an enforcer refrains from assuming standard-setter and audit functions, and from issuing interpretations of accounting standards.

2.4.3 Governance mechanisms

47. Governance principles are critical for the establishment and functioning of an efficient institutional mechanism. These principles might ensure that governance arrangements are in place to protect the integrity of the MCE process and to address conflicts of interest.

48. An adequate organizational structure need to be established to encourage a fair, transparent and efficient process, including coordination mechanisms with other areas of legislation, regulation and other authoritative bodies at the national and international levels, as well as at the regional level, if applicable.

2.4.4 Activities and methodologies

49. An MCE system needs to include a set of specific activities related to the monitoring of compliance and enforcement, and methodologies, where appropriate.

2.4.4.1 Activities

50. Activities include the selection of firms to be inspected, inspection procedures, incentives, disciplinary measures and sanctions, promotion and awareness-raising, and allocation of appropriate human, financial and technological resources for the monitoring, prevention and correction phases.

51. IOSCO emphasizes that in an effective and credible enforcement system, a 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; and

    (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.

2.4.4.2 Methodologies

52. Methodologies need to be in place and action taken for both the prevention and correction phases, regarding all defined activities.

53. An MCE system needs to encourage compliance and prevent violations. In this regard a combination of an “accommodative” and a “sanctioning” approach is important. A “compliance” or “accommodative” approach is associated with cooperative, persuasive, and self-regulatory strategies, while the “deterrence” or “sanctioning” approach relies on prosecution and punishment in order to secure compliance through deterrence.[25]

54. The compliance or accommodative style aims to prevent violations and secure long-term cooperative compliance by persuasion, negotiation, bargaining and education. The objective is to achieve compliance, with penal sanctions used only as a last resort, as this approach often regards penalties as a failure to ensure compliance through other means. This approach tends to rely on constructive and active engagement with the subjects it aims to regulate.

Box 3. Example of prevention and correction

In the United Kingdom, regulatory officials generally prefer to use strategies of education, persuasion and cooperation to persuade businesses to voluntarily and preventively comply with regulatory rules in the first instance, rather than to use adversarial and punitive means to sanction non-compliance.

Sources: OECD, 2000.

55. By contrast, the sanctioning/deterrence style is to a larger extent based on laws, and it is

[25] M Aalders and T Wilthagen, 1997, “Moving beyond command-and-control: Reflexivity in the regulation of occupational health and safety and the environment, 19 *Law and Policy*, pp. 415-443; J Scholz, 1997, Enforcement policy and corporate misconduct: The changing perspective of deterrence theory, 60(3), *Law and Contemporary Problems*, pp. 253–268.

considered a less flexible approach. It is oriented towards punishing breaches of legal rules and is associated with reacting to harm-causing conduct and action. Proponents of the deterrence/sanctioning approach have argued that companies and firms are profit maximizers and will comply only when it is in their rational economic interest to do so and that heavy penalties are therefore the relevant incentive to achieve compliance. However, others have taken the view that this analysis of corporate behaviour is not an accurate description of the reality of compliance in most regulated firms. Management is much more likely to perceive the negative impact of non-compliance to be associated with bad publicity than financial penalties.

56. While accommodative compliance approaches are important, academic evidence also finds that enforcement is essential, both as a method for dealing with the minority of organizations that do not comply, and as a deterrent to prevent others from non-compliance. Regulatory law without any enforcement has shown to be ineffective.

57. It is the establishment of a threshold level of credibility regarding the reality of enforcement through a few demonstration cases, rather than necessarily the pursuit of large numbers of enforcement cases, which impacts behaviour. This could explain why developing countries (where the credibility of new laws may need to be demonstrated through enforcement) show measurable improvements in market outcomes after enforcement cases, while this effect is harder to observe in developed countries that already have a credible regime. However, regulators in advanced economies undertake enforcement cases in order to demonstrate the credibility of new areas of law where it does not yet seem to be established, or where there are doubts regarding the credibility of its regime.

58. A mix of tools employed flexibly, in constructive engagement with the subjects that need to be regulated, could be suggested as an appropriate way forward, as long as there is always the real possibility of escalation to tougher measures.[26]

2.4.4.3 Methodologies for the selection of entities for inspection

59. Selecting entities and individuals for inspection is one of the key activities of MCE, while the selection methodology is an essential element of the system.

60. Competent authorities can select organizations or professionals to inspect, based on a risk-based approach and then can apply either random sampling or rotation, or both.

61. Risk determination is based on a combination of the probability of infringements and the possible impact of a potentially significant infringement on financial markets. Other aspects that may be considered in developing selection criteria are indicated in the relevant sections of the current guidance.

2.4.4.4 Conducting inspection and examinations

62. Another important responsibility of MCE concerns the activities and procedures related to examination and inspection, as follows.

2.4.4.5 Incentives

63. Incentives of the enforcement system can play an important role in promoting high-quality corporate reporting and can replace sanctions in specific circumstances.

64. For instance, if certain criteria are met, the following measures can be imposed or encouraged by the competent authorities to organizations subject to their review (enterprises subject to accounting rules; and accounting and auditing firms subject to technical and ethical standards):

    (a) Coaching (by other professionals);

    (b) Internal compliance programmes (including training, internal quality review, etc.).

65. Such incentives (replacement of sanctions by positive measures improving the quality of the organization) can be used in cases where:

    (a) Organizations were considered not having complied with specific standards;

    (b) This non-compliance has no negative impact on the true and fair view of the financial statements; or

[26] City of London, 2009, *Assessing the Effectiveness of Enforcement and Regulation*, available at http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Assessing-the-Effectiveness-of-Enforcement-and-Regulation.aspx (accessed 7 February 2017).

(c) Organizations are taking immediate action to improve their internal systems in order to comply with the relevant standards.

66. Organizations may have a variety of motivations for the regulation of their activities, and they may react in different ways. Effectiveness in gaining compliance may thus depend on the ability of the regulator to adapt its strategy to different settings, using the compliance gaining tools at its disposal in different "mixes", depending on the context.

2.4.4.6 Internal control and risk management

67. Within the MCE system, compliance with reporting standards depends on preventive actions such as internal control and risk management. It is important to integrate them into the internal governance framework of the entity.

68. In this respect, an important source of information could be the guidelines on internal control developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).[27] COSO focuses, among others, on the role of the board of directors to determine the company's risk appetite and to oversee the risk management systems implemented by the executive management of the company. The larger companies have developed their own manuals on the reporting and compliance process.

69. Internal procedures are important for a monitoring system. Hence, it is appropriate to become acquainted with good practices regarding:

(a) The application of internal management control models and the reporting on internal control systems and their regulation at the national level;

(b) State regulation and implementation of management control mechanisms;

(c) Compliance with the rules of corporate governance;

(d) Reporting on the status and effectiveness of company management.

70. According to the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing,[28] internal auditors should assess the risk management system used for the institution in planning audits, and, in the absence of such a system, it is necessary to apply one's own judgment regarding the risks to the institution, after consulting with its management and with the officers who are directly responsible for the functions and processes covered by the internal audit.

71. In order to manage risk effectively, it is important that firms ensure that procedures remain up to date and fit for their purpose in a changing environment.

72. If a firm is taking reasonable steps to reduce the risk of breaching financial sanctions, it is important to have up-to-date policies and procedures in place that are appropriate to its business, readily accessible and well understood by all relevant staff. A lack of written policies and procedures may lead to different interpretations of the firm's approach to financial sanctions, and therefore increase the risk of financial sanctions being breached in some parts of the firm. It is essential that firms have a good understanding of the financial sanctions regime. Without this, risk assessments are likely to be inaccurate and, as a consequence, systems and controls put in place to prevent a breach of financial sanctions may not be sufficient.

73. It is good practice to have an independent review of procedures carried out periodically by staff who are not involved in overseeing the firm's systems and controls for financial sanctions.

2.4.4.7 Disciplinary measures and sanctions

74. An MCE system could include a set of enforcement actions, such as corrective measures and sanctions. Enforcement efforts vary from one country to another, especially if they are adjusted for size of the capital markets or the economy as a whole.[29]

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[27] COSO, 2009, *Guidance on Monitoring Internal Control Systems*, available at https://www.coso.org/Pages/GuidanceOnMonitoring.aspx (accessed 7 February 2017).

[28] IIA, 2016, *International Standards For The Professional Practice Of Internal Auditing,* available at https://na.theiia.org/standards-guidance/Public%20Documents/IPPF-Standards-2017.pdf (accessed 7 February 2017).

[29] P Hinton and R Patton, 2011, *Trends in Regulatory Enforcement in UK Financial Markets,* available at http://www.nera.com/content/dam/nera/publications/archive2/PUB_FSA_

75. ESMA recalled the importance of the use of sanctions and suggested that enforcers be granted the power to take appropriate administrative or civil sanctions and measures in cases where the requirements of the relevant reporting framework have not been complied with. It proposed that enforcers should have the ability to take administrative sanctions, which are then made public in order to reaffirm the usefulness of enforcement when the financial reporting process has failed.

76. ESMA has taken note of the suggestion to grant an additional power regarding civil sanctions, and recalls that the legislation draws a clear line in the enforcement process between actions taken to protect investors and sanctions taken to punish wrongdoers. ESMA does not deal with the latter in its Guidelines, as the power to issue and use sanctions is dealt with in the primary legislation (at European and national level) and falls outside of ESMA's remits. Article 28 of the amended Transparency Directive provides an adequate legal basis for ensuring appropriate sanctions in all European countries in case of breaches.[30]

77. It is important to describe the difference between criminal and discipline sanctions or corrective measures, such as warnings, notifications and remedies such as continuing professional development (CPD).

78. Practices vary from country to country and depend on the regulation, but the first question that needs to be answered is who has the power to start the investigation. In this regard, it is also necessary to clarify the role and relations of criminal prosecutors and disciplinary authorities in terms of their access to the data.

2.4.4.8 Raising awareness

79. It is important that procedures of regulators be transparent, and competent authorities periodically provide information to the public on their MCE activities and coordination. Public announcements are usually imposed in cases where material misstatement is detected. It is important to establish a methodology of reporting, in order to define which stakeholders need to be notified of the inspection results, and which issues need to be communicated in different scenarios.

80. The methodology can also include procedures to alert stakeholders with regard to the new requirements or any planned material changes to the previous regulation, if these changes might affect their positions, financial instruments, contracts or existing benchmarks.

81. The ESMA Guidelines state that the publication of changes in the regulation should allow stakeholders to understand how the benchmark was derived, and to assess its representativeness and relevance to particular stakeholders.[31] The rationale for any proposed material change in the methodology should be published, the procedures for making such changes. These procedures should also clearly define what constitutes a material change, and the method and timing for consulting or notifying subscribers (and other stakeholders where appropriate, taking into account the breadth and depth of benchmark use) of changes.

2.4.5 Competent staff

82. The most critical element of an effective MCE system is adequate human resources. The lack of availability of competent staff presents a major challenge towards building such systems in many countries, and capacity-building programmes are greatly needed to address this challenge.

83. The specific skills required of staff dealing with MCE depend on their role and may include a thorough knowledge of accounting standards, relevant experience in carrying out audits and quality assurance reviews, as well as the necessary analytical skills for inspection, investigation and prosecution. Legal training would also be required in situations where assessment of evidence of wrongdoing is needed in the context of national legislation and regulation.

Trends_0711.pdf (accessed 7 February 2017).

[30] ESMA, 2012, *Activity Report of the IFRS Enforcement activities in Europe in 2012,* available at https://www.esma.europa.eu/system/files_force/library/2015/11/2013-1022_activity_report_on_ifrs_enforcement_in_europe_in_2012.pdf (accessed 7 February 2017).

[31] ESMA, 2014, *Guidelines on enforcement of financial information*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf (accessed 7 February 2017).

84. It is critical that staff involved in MCE activities have appropriate professional competency and experience, and be sufficient in number. Attention should be paid to the availability of appropriate technology, the skills to use such technology in an efficient way and continuous training requirements to uphold high standards of oversight as part of the MCE system.

85. Regulatory bodies often face challenges in their ability to hire personnel with the necessary expertise. This is due, among others, to skills mismatches and discrepancies in remuneration between the regulator and its regulated entities, or between the public and private sectors. The staff recruitment process should reflect the need to strike a balance between experience of the reporting industry and the independence required in the monitoring role of MCE.

86. In this respect, education standards become an important mechanism for improving staff competency. For instance, training programmes for staff working with MCE and audit regulation should be designed in such a way that trainees gain a good understanding of the IAASB standard on professional scepticism.

2.4.6 Funding models

87. An effective MCE system requires appropriate financial resources without which it would be unable to fulfil its mandates and contribute to a high-quality reporting environment. In this regard, an appropriate funding model constitutes an important element of such a system.

88. The source of funding depends on the national regulatory landscape, but typically involves a mix of levies on listed companies, professional reporting bodies, or on audit firms that operate in the country. In jurisdictions where capital markets are less developed, specific public funding may be necessary for the implementation of the MCE requirements. With regard to funding models, it is important to establish mechanisms that ensure the independence of the MCE system and its agents from providers of financial resources.

2.4.7 Evaluation and impact assessment mechanisms

89. Successful implementation of an MCE system depends on evaluating the impact of such a system on the quality of corporate reporting in a way that is comparable and consistent over time. It should aim to ensure the system's efficiency, continuous improvement and capacity-building along every step of the reporting supply chain. It could include a set of indicators, which would help identify gaps and priorities for further improvements and adjustments in the MCE system and its specific areas.

90. Due to their complexity and holistic impact on the corporate reporting landscape, measurements are often imprecise and rely upon imperfect proxy inputs. Outcomes of regulatory actions are sometimes confidential or unobservable to third parties. Limited information may be available about cases that regulators decide not to pursue as part of their reporting oversight strategy.

91. Building an effective MCE system requires a mechanism for assessing the process and progress of building and strengthening the system, including the development of a set of indicators to measure and evaluate its impact on the quality of corporate reporting in a comparable and consistent manner.

92. Regulators, policymakers and academics around the world are beginning the search for adequate measurement criteria in order to judge what is, and is not, effective. A first generation of such measurements focused on inputs and outputs. Input metrics include the level of resources (number of staff and salaries) assigned to enforcement. Output measures include the nature of actions taken (criminal or administrative), the specific type of sanction sought (prison, monetary penalty), and the number and amount of sanctions imposed (years of imprisonment, amount of monetary penalties, number of remedial actions implemented). Some measurements relate to efficiency, such as the time required in taking a case from the investigation stage to adjudication. Others measure success rates include the number of cases opened versus the number successfully concluded. Regulators in many countries use these metrics as tools to evaluate their performance, which they report to the public and to the government bodies to which they are accountable.

Box 4. Examples of effectiveness assessments of MCE

Some regulators, such as the United Kingdom Financial Conduct Authority (FCA), have begun to use a second generation of metrics, designed to capture the outcome of the enforcement effort. These measurements include conducting surveys to measure investor (and market participant) perception of the effectiveness of the enforcement programmes. This information is helpful to regulators, as it points to the outcome of the programme (perception of credibility in the market place), but, like the other measurements described above, it is an incomplete approach. In addition, FCA has sought to measure the “cleanliness” of the market as a measurement of its enforcement programme. The research focuses on the change in price ahead of corporate announcements as a measure of whether fair disclosure and insider trading rules are complied with. The FCA has commissioned several independent cleanliness reports, all of which have shown that price movements indicate that the market is not entirely clean.

Sources: Carvajal and Elliot, 2009.

93. To assess MCE systems, the UNCTAD Accounting Development Tool (ADT) introduces several quantitative indicators, which are directly related to the level of development of an MCE system in a given country[32] and help to evaluate the following aspects:

(a) Existence of MCE-related functions;

(b) Independence;

(c) Adequate funding and staffing;

(d) Selection criteria for inspections;

(e) Methods for reporting findings;

(f) Imposition of public sanctions;

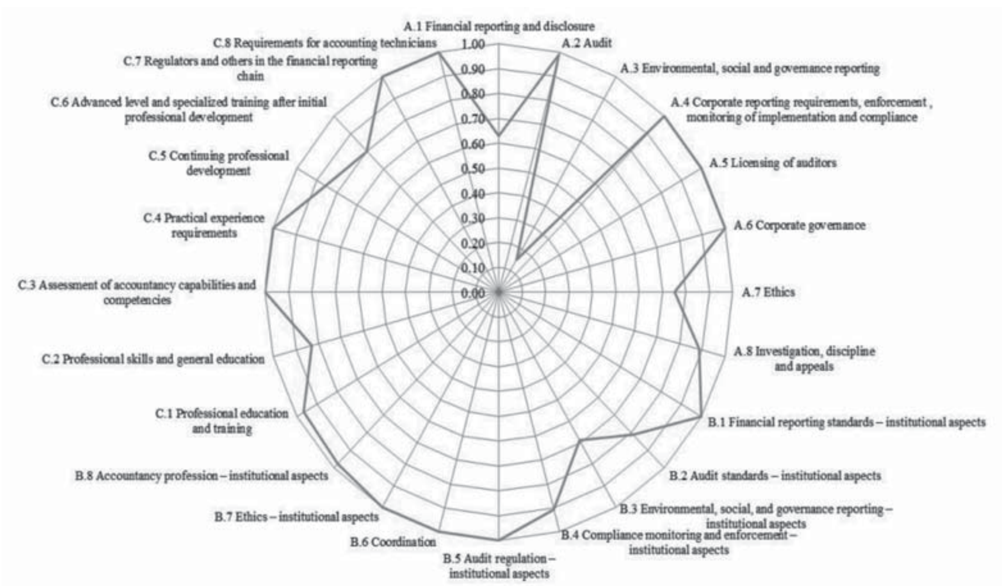
(g) Licence requirements for auditors;

(h) Codes of ethics and committees of investigation;

(i) Discipline and appeals for professional accountants;

(j) Coordination mechanisms for national institutions.

94. As an output, the ADT provides its users with a graphical representation of the gaps between the existing national requirements and international good practices. The following spidergram provides a depiction of a country’s performance in MCE-related elements:



[32] UNCTAD, 2013b, *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 7 February 2017).

95. Impact assessment should be analysed at every step of the reporting chain, and encourage appropriate feedback (including the collection of evidence) on how to improve the effectiveness of the MCE system. Examples of assessment methodologies in this area include the European Commission's Effects Analysis of IFRS, and the World Economic Forum's Global Risks Perception Survey.[33]

[33] WEF, 2016, available at http://reports.weforum.org/global-risks-2016/executive-summary (accessed 7 February 2017).

III. MCE REQUIREMENTS FOR CORPORATE REPORTING

3.1. DEFINITION

96. MCE in the area of corporate reporting refers to the functions performed by independent regulators to ensure the compliance of a company's financial information with corporate reporting standards and the relevant reporting framework required by a country.

97. According to the ESMA Guidelines on the enforcement of financial information, accounting enforcement consists of 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.

98. 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,[34] as well as with regard to non-financial information.

3.2. SCOPE AND OBJECTIVES

99. Corporate reporting can cover various entities, such as listed companies, State-owned enterprises (SOEs), non-listed companies, and small and medium-sized enterprises (SMEs). It can also include non-financial reporting on environmental, social, anti-corruption, human rights, diversity, corporate governance, remuneration, internal control and risk management issues. It is important for regulators to clearly state what entities and types of information are included in the scope of the MCE system for corporate reporting requirements. The system may cover all or some of entities, such as public interest entities (PIEs), listed companies, credit and financial institutions, SOEs, as well as non-listed companies and SMEs.

100. One of the critical areas to be addressed when building an MCE system for accounting and reporting standards is what might be reported and therefore what might be subjected to the MCE. In this regard a materiality principle is key. Despite all the efforts made towards developing consensus in this area, different views still exist regarding the practical application of this concept among issuers, auditors, possible users of the financial and sustainability reports and, in some instances, accounting enforcers.

101. ESMA published a consultation paper in 2011 (ESMA/2011/3738) considering the role and implication of materiality in financial reporting. In 2012, ESMA published the summary of the 50 responses received (ESMA/2012/5259) and organized a public round table to discuss topics where further clarification was needed. The ESMA Securities and Markets Stakeholder Group on issues related to enforcement activities and to the convergence of supervisory practices in Europe stresses the importance of the concept of materiality and its appropriate assessment within the definition of the IFRS Conceptual Framework and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. In its view, the same principles might be applied in assessing materiality for reporting and for enforcement purposes. Further, the responsibility for determining the concept and definition of materiality for IFRS purposes might remain with the International Accounting Standards Board (IASB), while it is the role of enforcers to assess whether an error is material, using the IASB definition.[35]

102. A critical disclosure problem is excessive information in financial statements, also known as "disclosure overload". Disclosure overload can mean that useful information is obscured and that the connections between disclosures are not obvious. There is a view that a main cause of disclosure overload is that the concept of materiality is not being applied appropriately.

[34] Brown et al., 2014, Measuring country differences in enforcement of accounting standards: An audit and enforcement proxy, *Journal of Business Finance and Accounting*, 41:1–52, available at http://onlinelibrary.wiley.com/doi/10.1111/jbfa.12066/pdf (accessed 7 February 2017).

[35] ESMA, 2012, *Activity Report of the IFRS Enforcement activities in Europe in 2012*, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf (accessed 7 February 2017).

103. Another aspect of the disclosure problem is that often the relevant information is not being disclosed. It has been argued that a better application of materiality might not only result in a reduction of disclosure overload, but also in better (more relevant) information being disclosed, whether specifically required by IFRS or not.

104. ESMA states that it will continue to engage with IASB and IAASB in respect of key messages arising from the consultation process, and provide both relevant enforcement examples where consistent application of materiality was found to be problematic and relevant input for the project started by IASB on the disclosure framework.[36] IASB has two projects that form part of the Disclosure Initiative, which plans to address materiality:

(a) Amendments to IAS 1;

(b) Materiality assessment of existing guidance.

105. It is important to consider issues of non-financial reporting when determining the scope of MCE of corporate reporting.

106. The attention paid to non-financial reporting is increasing. An example is the new European Union directive that makes the disclosure of non-financial information mandatory, starting in 2017.[37] Furthermore, public sector reporting, and in particular payments made to Governments, is also a relevant area for monitoring. However, until more robust reporting standards are established in these areas, monitoring needs to be conducted on a reward basis in quest of the best reporting.

[36] Idem.

[37] UNCTAD, forthcoming, Review of good practices on enhancing the role of corporate reporting in attaining Sustainable Development Goals.

3.3. INSTITUTIONAL ARRANGEMENTS

107. To establish mechanisms on compliance with statutory accounting and reporting requirements, the following actions might be considered:

(a) Define the standards on which the MCE system is based;

(b) Decide on the composition of the panel that will perform reviews;

(c) Set the criteria for the selection, training and evaluation of reviewers;

(d) Set the criteria for the selection of issuers for monitoring;

(e) Formulate the classification of the findings;

(f) Establish review and sign-off procedures as part of internal quality control;

(g) Decide on the method of reporting findings to the issuer, audit firm and regulator, including the registrar of companies;

(h) Establish corrective action on serious non-compliance issues by issuers;

(i) Establish criteria under which non-compliance can be made public and under what circumstances would a regulator make it public;

(j) Define requirements, action statements and findings with regard of the use of financial statements for the competent authorities to report on their regulatory activities.

108. The competent authority conducting the MCE activities varies depending on the institutional arrangements in a country. The following box provides examples of such institutional arrangements.

Box 5. Examples of enforcement settings for corporate reporting

In the European Union, the monitoring of listed entities and enforcement of financial information is performed at a national level. According to Standard No. 1, enforcement activities should be conducted by competent and independent administrative authorities or by other bodies on their behalf but subject to their oversight.

According to ESMA's annual reporting, 2015 enforcement was carried out by one authority in most countries. In Denmark, one authority deals with financial information in prospectuses, as well as

Box 5. Examples of enforcement settings for corporate reporting

periodic financial information of financial entities, and another authority deals with periodic financial reporting by non-financial entities. Portugal has a similar system in which one authority is in charge of the enforcement of financial information of all issuers, but shares those responsibilities with the prudential supervisors for the financial institutions and insurance companies. The Transparency Directive allows other organizations to carry out enforcement activities, provided that they are supervised by the relevant competent administrative authority. However, in Ireland and the United Kingdom, two authorities are involved: one deals with periodic financial reports and the other with financial information in prospectuses. Countries such as Austria and Germany have a two-tier system in which two separate institutions participate in the related activities at different stages.

In Germany procedures at the first level are conducted by the Financial Reporting Enforcement Panel. If a company does not cooperate with the examination, does not agree with the findings or if there are substantial doubts as to whether the examination was properly conducted, the Authority enters at the second level and can take supervisory measures. The stated legislative purpose of the two-tier mechanism is based on the notion of adverse disclosure effects. This mechanism and the ensuing costs are aimed at establishing incentives for firms to comply with the accounting guidance, thus improving accounting quality. It also intends to decrease the risk of collusion between auditors and clients. Thus, in addition to penalizing firms for accounting malfeasance, the main objective of the German disclosure mechanism is preventive in nature.

Sources: Berger, 2010; Boeckem, 2000; ESMA, 2016.

109. The majority of countries have one institution in charge of conducting such activities, i.e. a one-tier system. In many countries, a securities and exchange commission, or the superintendencies of companies, banking and/or the insurance sector, represents the authority in charge of conducting such activities.

Box 6. Examples of different types of institutional oversight systems for listed companies

Stock exchanges

In Norway, Sweden, and Switzerland, stock exchanges have the responsibility for enforcing financial reporting requirements. In other countries where the stock exchange has a regulatory role, this is often limited to prospectuses and interim financial statements of listed companies, or the stock exchange’s reviews are limited to formal checks. There is a tendency to take the enforcement task away from the stock exchange and bring it into an independent oversight mechanism: the stock exchange regulator or otherwise.

Stock exchange regulators

In Belgium, France, Italy, Portugal and Spain, an independent regulator/supervisor exercises control over the stock exchange(s) and enforces the financial reporting standards for all types of reporting, including the annual financial statements for listed companies. In some countries, developments are taking place to combine the various regulators (financial institutions, insurance undertakings and stock exchanges) into one regulator. The Paris, Amsterdam and Brussels stock exchanges have merged (Euronext). It is not known yet what impact this will have on the regulatory side. The regulators are organized at the European level in the Forum of European Securities Commissions.

Box 6. Examples of different types of institutional oversight systems for listed companies

Review panels

In the United Kingdom, a privately organized review panel – the Financial Reporting Review Panel – functions on a reactive basis by investigating complaints that are brought to its attention. If the complaint is valid, the review panel can seek corrective action, which would include presenting the case to the Court. The strength of this mechanism lays also in the public "naming and shaming" by means of press communications.

Governmental departments

In some cases, there is a department within the Government that has the task of enforcing financial reporting standards for the annual financial statements of all companies (often not only listed companies, but also unlisted companies). This is in particular the case for regulated industries, such as financial institutions and insurance undertakings. In Czechia, Denmark and the United Kingdom, there is a governmental department that enforces the accounting standards by reviews in substance.

Sources: FEE, 2002.

3.4. ACTIVITIES

3.4.1. Selecting companies for review

110. An essential element of an MCE system for corporate reporting is the methodology for selecting companies to be reviewed.

111. For instance, according to the ESMA Guidelines, enforcers select companies based on a combination of a risk-based approach and either random sampling, 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, the risk profile of the issuer and the experience of management and auditors are also considered.

112. Other aspects that may be considered in developing selection criteria include:

(a) Risks related to a specific sector;

(b) Relevance of the financial information to other issuers;

(c) Common findings from previous examinations;

(d) Complaints received;

(e) Referrals by other regulatory bodies;

(f) Issues raised in the media;

(g) Academic research.

113. The risk-based selection approach is not based on issuers' size, but rather on the level of complexity of their activities, their corporate structure, significant changes in accounting principles and the historical analysis of the compliance in the financial information previously disclosed.

Box 7. Examples of selection methodology

In Germany, risk-based selections accounted for 15–20 per cent of investigations and random sampling made up 80–85 per cent of investigations. 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, or based on random sampling.

Box 7. Examples of selection methodology

In the United Kingdom, the Financial Reporting Council's (FRC) Corporate Reporting Review selects annual reports for review in three ways:

- A risk-based approach: picking listed companies which operate in "priority sectors" – set annually – which are of topical risk, financial institutions during the financial crisis, or suppliers to companies in the oil and gas sector which have been affected by recent volatility in the oil price).
- Topical issues: companies that, irrespective of the sector, are most likely to have a topical issue (for example, after the adoption of a new accounting standard or those which have entered into a particular form of pension agreement).
- Complaints, regardless whether the whistleblowing comes from within a company, or a complaint was received from a shareholder or from another relevant stakeholder, such as tax authorities.

Sources: Hitz et al, 2012.

3.4.2. Examination procedure

114. An important decision to be made is the nature of the examination procedure to be chosen, regarding the frequency of reviews

115. For instance, ESMA's Guidelines state that enforcers can either use unlimited scope examination or a combination of unlimited scope and focused examinations of the financial information of issuers selected for enforcement. An unlimited scope examination of financial information (previously called a full review) is the evaluation of the entire content of financial information, in order 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 predefined issues in financial information and the assessment to what extent the financial information is compliant with the relevant financial reporting framework regarding those issues. The sole use of focused examination is not considered satisfactory. These Guidelines provide examples of examination procedures, including the following:

- Reviewing annual and interim consolidated financial reports.
- Asking questions to the issuer concerning areas with significant risks and accounting issues.
- Asking questions to auditors.
- Referring matters to the bodies responsible for the audit and/or approval of financial information.
- Identifying sectorial accounting issues.
- Engaging external experts.
- Engaging in on-site inspections.

116. The ESMA Guidelines recommend the documentation of the examination techniques used, and the issuing of a review. After the review, potential infringements that have been identified are discussed with the issuer. If the accounting treatment is not acceptable and a material misstatement[38] is detected, there is a range of actions available, depending on the jurisdiction. The following action might be required: that revised financial statements be issued, that corrective notes or other announcements be published, or that corrections be made to future financial statements. If departure from the financial reporting framework is immaterial, the enforcer sends a notification to the issuer and this is usually not made public.

117. To decide on the frequency of reviews, it is necessary to determine the group of companies for review:

(a) All companies;

(b) Largest companies;

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

(c) Companies included in a stock index;

(d) Debt-issuers;

(e) Companies that had unsatisfactory results;

(f) Companies selected by a risk-based approach.

118. The number of companies for review is determined as an absolute number or a percentage of the total number of companies from each, one or several of these groups.

119. The frequency of reviews is determined by the following indicators:

(a) Maximum frequency of reviews (the period which necessarily must pass from the previous to the next company review);

(b) Minimum frequency of reviews (the period after which the company become the subject of mandatory review).

120. Countries have to choose these options, depending on the scale and features of the national economy, financial market development and the number of entities and percentage of performance previously established review plans.

Box 8. Examples of examination procedures

Practices vary significantly in this regard, as shown by the following examples:

- Denmark – 20 per cent of the companies each year. Due to the use of a risk-based approach, companies may be selected several times within a five-year period.
- France – the 140 largest companies every three years and the rest every five years.
- Germany – the Financial Reporting Enforcement Panel requires an examination every four to five years of all companies included in a stock index, and every eight to 10 years of all other companies. In 2013, the Panel completed a total of 110 examinations.
- Netherlands – in addition to a risk-based selection, the goal is to examine each equity issuer every five years and each debt-issuer every seven years.
- Italy – at least 20 per cent of the companies each year.
- Spain – equity issuers are examined approximately every two years and debt issuers, approximately every six years.
- Switzerland – in addition to a risk-based selection, the goal is to examine each company every six years.
- United Kingdom – in case of a satisfactory outcome, the entity is reviewed every six years. Unsatisfactory results are reviewed in four years, and clearly unsatisfactory results in two years.

Sources: Berger, 2010.

3.4.3. Enforcement actions

121. A range of actions could be used in relation to enforcement actions of the MCE system on reporting requirements.

Box 9. Examples of enforcement actions for MCE

The United Kingdom Financial Conduct Authority has a range of disciplinary, criminal and civil powers with which it can sanction firms and individuals whose conduct fails to meet the required standards, or otherwise violates the law. In addition to financial penalties, FCA has the power to:

- Require firms to conduct skilled persons' reports to obtain independent views of aspects of firms' activities under investigation.
- Censure firms or individuals through public statements.

Box 9. Examples of enforcement actions for MCE

- Effect disgorgement of any monetary benefit derived from misconduct by imposing a fine of this amount on top of any penalty.
- Require that a scheme be established to achieve customer redress (i.e. amounts paid directly to customers rather than to the FCA).
- Restrict the ability of individual firms to engage in certain regulated activities for which authorization is required (suspension or prohibition).
- Seek civil court orders to enjoin conduct, freeze assets, close down a firm (insolvency procedure) or order restitution (from entities not subject to redress requirements of the Financial Services and Markets Act).
- Prosecute firms or individuals for acting without authorization or for other illegal acts.

In general, the United Kingdom approach works as an incentive for firms to promptly improve their practice. The FRC Conduct Committee's operating procedures explain that the outcome of a review might be no action, a reference in the next annual report that something had been corrected or improved as a result of the intervention of FRC, a press notice issued by the FRC, voluntary revision by the company or, in extreme circumstances, an application to the court for revision of defective accounts at the company's directors' personal expense. This range of sanctions offers a proportionate response. Separate press notices, for example, are usually issued when an issue is more significant.

In Nigeria, any person who fails to comply with the prescribed statement of accounting and financial reporting standards, developed by the FRC, commits an offence and is liable on conviction to a fine or imprisonment for a term not exceeding two years, or both. Any public interest entity that fails to comply with the standards is liable to a fine and will be required to restate the relevant financial statement within 30 days and to disclose the same in the following year's financial statement. The professional who prepared the financial statement, in addition to fine and imprisonment, might be delisted from the register of professionals by the Council of the professional accountancy organization.

Sources: FRC, 2016; Hinton and Patton, 2011.

122. IOSCO states that security measures that could be adopted by securities regulators must demonstrate the availability of a variety of sanctions that are proportionate, dissuasive, effective and sufficient to cover the spectrum of securities violations, examples of which could include the following:

(a) Fines;

(b) Disqualification;

(c) Suspension;

(d) Revocation of authority to do business;

(e) Asset freezes;

(f) Action against unlicensed persons in conducting securities transactions, or referral of such activities to criminal authorities;

(g) Measures to enforce disclosure and financial reporting requirements for issuers.

3.5. MONITORING ARRANGEMENTS AND IMPACT ASSESSMENT

123. Building an effective MCE system for accounting and reporting requires developing a set of indicators to assess the impact of implemented actions and to identify gaps and priorities for further improvement. For instance, one of such indicators is the number of satisfactory and unsatisfactory test results.

124. Clearly, preparers have the main responsibility in the reporting process. The strengths, weaknesses and quality of the preparation of the report can be tested according to the following activities:

(a) Accounting and software systems used (data collection);

(b) Closing process and schedules (including flow charts and responsibilities);

(c) Management reviews (including audit committee);

(d) Involvement of internal auditors;

(e) Filing deadlines (the shorter the better);

(f) Competence and education of staff (e.g. professional designations).

Box 10. Examples of impact assessment methodologies

The Conduct Committee of the United Kingdom Financial Conduct Authority publishes an annual report summarizing corporate activities in overseeing financial reporting. This document sets out the priorities for the year in question, measures indicators such as the speed with which a company under investigation deals with the FRC's correspondence and concerns, and summarizes the main areas of challenge (which in turn acts as a pointer for issuers and auditors in subsequent years).

The FRC follows three guiding principles in producing impact assessments:

- The work that goes into the production of an impact assessment might be proportionate to the importance of the proposal that it covers;
- Where a standard is being introduced as a direct response to legislation or regulation, or as part of an agreed policy commitment to adopt international standards of accounting or auditing, the impact assessment might explain the rationale for introducing the standard and might focus on any aspects of the proposed standard which augment the relevant legislation or augment or diverge from the relevant international standard;
- Where appropriate, the impact of proposals on small businesses might be considered.

Sources: FRC, 2015a; FRC 2016b.

IV. MCE REQUIREMENTS FOR AUDITING AND QUALITY ASSURANCE

4.1. DEFINITION

125. In this document, audit regulation refers to the MCE-related activities of auditors and audit firms, particularly with respect to listed companies and public interest entities. This includes professional standards and codes applied for the analysis of information reported by organizations, as well as quality assurance.

4.2. SCOPE AND OBJECTIVES

126. The scope of the MCE for the audit function varies across jurisdictions. In many countries, it is mainly directed to audit firms in charge of reviewing listed companies, while other countries broaden the focus to include other public interest entities and financial institutions, as well as individual auditors. In some jurisdictions, the scope of MCE systems encompasses all audits.

Box 11. Examples of audit oversight

Under the European Union Audit Directive, auditor oversight (including the ability to take enforcement action) applies to public interest entities (including listed companies, banks and insurance companies) and large and medium-sized companies. If a Member State of the European Union chooses to do so, it can also include mandatory and voluntary audits of small companies. Enforcement action for public interest entities rests with an independent oversight body, while for non-public interest entities, this may be another suitable body, e.g. a professional accountancy body.

In the European Union, non-financial information is often subject to an existence check, and possibly a consistency check with the annual or consolidated accounts, by the statutory auditor. It can also be subject, on a voluntary basis, to an external assurance engagement (e.g. based on ISAE 3000). The FRC follows three guiding principles in producing impact assessments:

127. One of the most important decisions would be to define the scope of work and the tasks to be performed by the competent authority. Based on existing practices, the following aspects are to be considered in this are as follows:

    (a) Define the standards against which monitoring will take place;

    (b) Decide on the composition of the monitoring team;

    (c) Set the criteria for the selection, training and evaluation of reviewers;

    (d) Set the criteria for the selection of firms and audits for monitoring;

    (e) Design an appropriate monitoring programme and checklists;

    (f) Formulate the classification of the findings identified through the monitoring process;

    (g) Establish review and sign-off procedures as part of internal quality control;

    (h) Decide on the method of reporting the findings regarding the firms monitored to the regulatory authorities, including PAOs; establish regulatory action and follow-up procedures on unsatisfactory visit outcomes;

    (i) Consider the interaction with licensing and disciplinary systems.[39]

128. Including individuals adds costs and complexity to the system, but the advantage is the ability to sanction individuals directly, rather than through their employers. It may also help identify auditors who have been sanctioned while at one audit firm and who attempt to join

[39] UNCTAD, 2013a, *Accounting Development Tool: Building Accounting for Development*, United Nations publication, UNCTAD/DIAE/ED/2013/7.

another firm in order to continue their auditing activities. There are also other important reasons why some jurisdictions might focus on individual auditors; and that has to do with legal and registration requirements.

129. It is worth demonstrating that an individual or firm's liability depends on the national legal system and that different approaches exist in this regard. The implications of different systems must necessarily apply to disclose the following:

(a) Conditions of the appointment of external auditors and audit firms;

(b) Criteria for inclusion in the register of audit companies (structure of their ownership and their representation in a regulatory body authorized in the country);

(c) Conditions of release and reasons for rejection of the audit by external auditors and audit firms, including the statutory audit of public interest entities.

Box 12. Examples of MCE systems for auditing

Brazil: The partner signs together with the firm. If there is a prosecution, depending on the sentence, the partner can lose his/her registration. The audit firm also receives peer review by another firm selected by the Securities and Exchange Commission.

Canada: Performs within the dual model where the partner signs auditor's reports with his/her licence number.

Nigeria: It is not only necessary for the auditor to sign the auditor's report, but also to provide the partner licence number. The partner will not be able to continue working if the licence number is withdrawn due to non-compliance.

Singapore: Partners also need to be licensed to sign the auditor's report. The amended legislation allows a firm to call itself a chartered accountant if only 75 per cent of partners are certified accountants, while the others can be lawyers, engineers, etc. This explains the reason why the major focus is on individuals, not on firms.

Switzerland: The priority is given to the type of licence that is listed on the auditor's report.

United Kingdom: There are four recognized supervisory bodies that issue audit licences that apply both to the individuals and the firms. The Association of Chartered Certified Accountants s (ACCA) regards a firm as an appointed auditor on the basis of the contractual nature of assignments, but sometimes the Licensing Committee can put sanctions against individual partners. ACCA tracks individuals through the central audit register. Figures from 2010/11 show that the frequency and size of fines imposed on individuals have grown more rapidly than for firms, which is consistent with a shift in enforcement focus towards sanctions against individuals. An increase in the use of criminal sanctions against individuals is also an indicator of tougher enforcement. However, it should be noted these cases would not generally apply to the regulatory action taken following a quality assurance review, as fines are rarely imposed on licensing issues. ACCA considers it more appropriate to impose safeguards when it comes to future licensing issues, rather than penalties that it finds more appropriate for past rule breaches.

Sources: Hinton and Patton, 2011.

4.3. KEY CONSIDERATIONS

130. The establishment of an effective institutional MCE system for auditing requires the development and implementation of certain key functions and principles to guarantee the high quality and objectivity of related mechanisms and procedures.

131. A sound MCE system for auditing generally includes the following:

(a) Requiring auditors to have adequate qualifications, professional competencies and relevant experience before being licensed to perform audits as well as CPD requirements for licensed auditors;

(b) Requiring auditor independence;

(c) Withdrawing authorization to perform audits if the requirement in (a) is not maintained, after a due process (with jurisdictional control).

132. For instance, IOSCO Principles for Auditor Oversight[40] note that matters to be considered in the audit oversight process could also include:

(a) Independence, integrity and ethics of auditors;

(b) Objectivity of audits;

(c) Selection, training and supervision of personnel;

(d) Acceptance, continuation and termination of audit clients;

(e) Audit methodology;

(f) Audit performance, that is, compliance with applicable generally accepted auditing standards;

(g) Consultation on difficult, contentious or sensitive matters and resolution of differences of opinion during audits;

(h) Second partner reviews of audits;

(i) Communications with management, supervisory boards and audit committees of audit clients;

(j) Communications with bodies charged with oversight over the financial reporting process, for example, on matters such as regulatory inquiries;

(k) Changes in auditors, or other matters as may be required;

(l) Provisions for continuing professional education.

4.3.1. Staff competencies

133. With regard to audit enforcement, the staff carrying out reviews of the quality assurance systems of audit firms needs to have appropriate professional training, relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews.

Box 13. Example of staff selection

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 auditing large corporations whose accounts are prepared in accordance with national and international accounting standards.

The review team should be composed of not only qualified and experienced accountants, but also other professional staff with industry expertise, which may vary, depending on the company and the industry. Lawyers' expertise may also be required.

4.3.2. Auditor independence

134. In designing and building an MCE system for auditing, the principle of independence is key, both for auditors and audit regulators. The external auditor's independent opinion is considered to contribute to the effective functioning of the capital markets, which value consistent and reliable financial reporting.

135. For the credibility of a MCE system, key principles include a separation of powers between the following activities:

(a) Standard-setting activities;

(b) Control of the application by the auditors of these standards (standards on auditing and ethical standards, including on the auditors' independence); such control may occur, when appropriate, through investigations, inspections, quality review and disciplinary procedures.

136. In recent years, auditor independence requirements have been strengthened (see, for instance, at the international level the IESBA Code of Ethics and at national level, the Sarbanes-Oxley Act.[41] Other examples are ISO guidelines or the European Union Audit Directive and Regulation of 2014.

[40] IOSCO, 2002a, *Principles for Auditor Oversight*, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf (accessed 7 February 2017).

[41] KPMG, 2009, *Audit Committee Institute as an oversight body*, available at http://docplayer.net/369785-Current-and-emerging-issues.html (accessed 7 February 2017).

137. As mentioned earlier, at the international level, IFIAR 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.[42] The principles state that a system of audit oversight can only be effective when certain preconditions exist, including:

(a) High-quality accounting and auditing standards;

(b) Legal requirements for the preparation and publication of financial statements;

(c) An enforcement system for preparers of financial statements;

(d) Corporate governance arrangements;

(e) Effective educational and training arrangements for accountants and auditors.

138. In the European Union, the selection of reviewers follows a procedure that ensures that there are 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, the audit fees charged and the internal quality control system of the audit firm. The audit firm may be notified, and the following might be arranged: 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.

139. Under European Union Regulation 537/2014 of the European Parliament and of the Council of 16 April 2014,[43] the independence of quality assurance inspectors/reviewers of public interest entities is to be further strengthened because inspectors/reviewers will need to be employed by the competent authority designated by Member States of the European Union as having ultimate responsibility for audit regulation:

(a) The competent authority designated by Member States as having ultimate responsibility for audit regulation cannot delegate this work to any other person or organization;

(b) The competent authority designated by Member States as having ultimate responsibility for audit regulation cannot be governed by practitioners. Article 21 of the regulation states that auditors cannot be members of the governing body.

[42] IFIAR, *Core Principles for Independent Audit Regulators*, available at https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 7 February 2017).

[43] European Parliament, 2014, *Regulation 537/2014*, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=EN (accessed 7 February 2017).

Box 14. Examples of governance requirements

The corporate governance code in the Russian Federation recommends separate disclosure of the amount paid to the auditor, distinguishing between remuneration for the audit, for other specified services, and for expenses.

In the United States, the final rule of Sarbanes-Oxley Act requires disclosure by the company of fees billed by the external auditor in the following four categories:

- Audit – Audit fees include those necessary to perform the generally accepted audit standards for audit of the company’s financial statements.
- Audit-related – Audit-related fees include services that are traditionally performed by the external auditor.
- Tax – Tax fees include all tax services other than those included in audit and audit-related services.
- All other – All other fees might include all other non-audit services.

140. The audit committee plays a key role in the governance of reporting entities and enhancing the quality of corporate reporting. Among other activities, the disclosure of audit fees could provide investors with a better understanding of how audit committees are managing relationships with the independent auditor.

141. Reviews by the IESBA, as part of its project on the topic, and the European Commission included an in-depth examination of the potential threat to objectivity arising from the provision of non-audit services to clients. Many countries already have professional safeguards against the loss of auditor independence, based on the principle that an auditor cannot audit his or her own work or be involved in management of the audit client. The revised IESBA independence standards further strengthen this guidance on a global basis. The IESBA Code recognizes that accounting firms have traditionally provided a range of non-audit services to their assurance clients. The threat to objectivity when providing non-audit services was the subject of an in-depth assessment by IESBA with input from global regulators. The major finding in most legislative/regulatory frameworks is that the audit committee is responsible for authorizing any additional fees based non-audit work.

142. The IESBA Code of Ethics specifies that an audit appointment might not be accepted if the client provides, for whatever work, an unduly large proportion of a firm's gross practice income. That approach limits undue financial dependency on any client without irrelevant restrictions on the balance between different types of income.

143. Best practice disclosures also require that non-audit fees be further analysed. For instance, such precaution may apply in the case of:

(a) Other audit-related work, such as workers' compensation returns;

(b) Securities or futures dealers' licence returns, reports to regulatory bodies;

(c) Other assurance-related services, such as due diligence and internal audit;

(d) Legal services;

(e) Advisory services, such as valuation and corporate finance;

(f) Taxation services;

(g) Consulting services.

144. This might be discussed with the external auditor as part of the audit committee's review

Box 15. Examples of requirements on non-audit services

In South Africa, the audit committee should preapprove any non-audit services to be provided by the company auditor. The external auditor of a company is not allowed to perform bookkeeping services and/or prepare financial statements of the same company.

In the Netherlands, all non-audit services for public interest entities are prohibited.

In the United States, SEC registrants must disclose fees paid to the auditor for audit and non-audit services.

A similar requirement applies to all medium-sized and large British companies (listed and unlisted). This disclosure allows stakeholders to assess actual or perceived independence threats which might impair audit quality. Companies can justify why a particular service does or does not impair independence.

In Canada, the regulation provides safeguards against the provision of non-audit services compromising independence. First, the ethical code forbids auditors to provide non-audit services to audit clients if that would present a threat to independence for which no adequate safeguards are available. Second, under the provisions of the regulation regarding disclosure of governance, the audit committee, as representative of the shareholders, is required to oversee the relationship with the auditors and keep the nature and extent of non-audit services under review.

Box 16. Examples of audit committee requirements

In the United Kingdom, the audit committee itself must ensure that the independence and objectivity of the auditor are not compromised. This important task is underpinned by the United Kingdom Auditing Standards, which specifically require that, for listed companies, audit engagement partners in the firm who are responsible for a company's audit must carry out the following tasks:

- Disclose in writing to the audit committee all relationships between the audit firm and the client that may reasonably be thought to bear on the firm's independence and the objectivity of the audit engagement partner and staff (including arrangements for ensuring that independence remains when non-audit services are commissioned) and the related safeguards that are in place;
- Confirm that, in their professional judgement, the firm is independent and the objectivity of the audit engagement partner and audit staff is not impaired.

The United States bases its requirements on the Sarbanes-Oxley Act of 2002. The Act mandates that audit committees be directly responsible for the oversight of the engagement of the company's independent auditor, and the Securities and Exchange Commission rules are designed to ensure that auditors are independent of their audit clients. The audit committee should discuss and thoroughly investigate any potential independence impairments or issues. The audit committee should also consider seeking guidance from a legal counsel, the auditor and the Office of the Chief Accountant.

Sources: ICAEW; SEC, 2007.

of the financial report.[44] The following boxes provide examples of requirements concerning non-audit services and audit committees.

4.3.3. Enforcement powers

145. Competent authorities need to have timely and effective mechanisms for obtaining and processing relevant information and enforcement powers to ensure that their recommendations or findings are addressed. These powers include the ability to impose a range of sanctions, such as fines and the removal of an audit licence and/or registration. It is important that these actions be subject to scrutiny and review, including appeal to a higher authority.

146. The auditors' oversight body, which has the ultimate responsibility, is entitled to withdraw an auditor's licence to practice as an ultimate sanction after a due process. The licence to practice a profession is considered a civil right. Civil rights are part of human rights and are subject to protection under the European Convention on Human Rights (ECHR) and the International Covenant on Civil and Political Rights (ICCPR), among others.

147. In particular, article 6 of the ECHR and article 14 of the ICCPR stipulate that the "tribunal" hearing a case must be independent and "impartial". Tribunals are defined in a broad sense, and include public authorities and disciplinary authorities deciding on civil rights. Impartiality is aimed at preventing a situation in which the same organ combines its judicial function with a legislative or an executive function.

148. Where an authority[45] is in charge of laying down rules[46] and enforcing their implementation and compliance, and has the ability to sanction their violation, human rights issues become a consideration. In this context, it might also be examined if a subsequent control is carried out by a judicial body having full jurisdiction and providing for all the guarantees relating to the right to a fair trial.

[44] KPMG, 2009, *Audit Committee Institute as an oversight body*, available at http://docplayer.net/369785-Current-and-emerging-issues.html (accessed 7 February 2017).

[45] Including a public authority having the ultimate responsibility to decide on civil rights, such as granting the licence to practice a profession.

[46] For example, standards on auditing or rules relating to the independence of auditors and principles such as guaranteeing that a tribunal is impartial.

4.4. INSTITUTIONAL SETTING AND ACTIVITIES

149. The institutional setting determines whether designated bodies are created or MCE functions for audit requirements are allocated to existing structures.

150. The competent authorities that perform such functions in the audit area vary across countries. In some cases, a government department may take statutory powers to set up a public oversight board or it may take these powers itself. In some cases, countries set up independent boards or regulatory bodies with a focused mandate and the authority to carry out the oversight function.

151. Countries may use more than one of the systems described above for the enforcement of financial reporting standards. As an alternative for the institutional oversight system, or in addition to it, all countries have sanctions or complaints systems whereby the respective responsibilities and rights of companies, their management, shareholders and auditors, and other stakeholders are detailed in law.

152. Self-enforcement, the approval of financial statements, and statutory audits are parts of the enforcement mechanisms that exist in all countries in Europe, which have many common features. However, there are some differences between the systems. For example, there may be one- and two-tier systems, and the involvement of the audit committee may differ across countries.

153. Oversight bodies and professional bodies both have a part to play in promoting and assessing audit quality. Independent oversight gives stakeholders increased confidence; professional bodies have a role to play in encouraging auditors to implement quality control with a view to maintaining the relevance of audit.

154. Independent audit regulators are normally in charge of the following activities:

(a) Conducting regular reviews of the 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.

Box 17. Examples of institutional settings

In Australia, Canada, Singapore, the United Kingdom, the United States and the European Union, regulatory oversight functions generally include registration, inspection, investigation, enforcement, standard setting and continuing education activities.

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 by establishing independent oversight of public company audits by PCAOB. 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.

Auditors of public companies, whose securities are registered with the United States Securities Exchange Commission and located in the United States or abroad, must be registered with and inspected by PCAOB. In some jurisdictions, the Board requires a cooperative agreement to conduct inspections. The Securities and Exchange Commission is responsible for appointing and removing Board members and for approving the Board's annual budget and accounting support fee. Adverse inspection reports of the Board, remediation determinations and disciplinary actions against registered firms and their associated persons are subject to review by the Commission. The Board establishes standards for auditing and related professional practice for registered public accounting

Box 17. Examples of institutional settings

firms, and publishes them for comments before adopting new standards or making amendments to existing standards. All Board standards must be approved by the Commission before they become effective. At the end of 2012, there were 2,363 firms registered with the Board, including 1,452 domestic firms and 911 firms from outside the United States, located in 87 jurisdictions. In 2012, the Board had a total of 766 employees. Many other countries have since followed the United States initiative and created independent oversight institutions.

In the United Kingdom, FRC oversees the regulation of the accountancy and actuarial professions by agreement with their professional bodies. FRC supervises six recognized qualifying bodies (RQB) in charge of granting individuals the audit qualification. It also recognizes four bodies, known as recognized supervisory bodies (RSBs) to register and supervise audit firms. RSBs conduct audit registration, audit monitoring, investigation of complaints, and procedures to ensure that statutory auditors maintain an appropriate level of competence. As part of implementation of European Union audit reforms, FRC has become the single competent authority, but will delegate its duties in respect of non-public interest entities to professional bodies subject to a right of recall.

Sources: Deloitte, 2013; Ernst and Young, 2012, United Kingdom Parliament, 2015.

4.4.1. Criteria for selection of the audit firms and inspection procedures

155. First, criteria for the selection of the audit firm to be inspected need to be established.

156. Many countries use a risk-based approach to select the firms to be inspected. In this context, it is advisable to disclose what criteria are applied by countries reforming their own systems of audit regulation in accordance with the best international standards.

157. The explanatory material on IFIAR principle 4 states the following:

> Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or non-compliant execution of an audit.[47]

[47] IFIAR, *Core Principles for Independent Audit Regulators*, available at https://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf (accessed 7 February 2017).

Box 18. Example of selection criteria

In the United Kingdom, the majority of public interest entities are audited by firms registered with the Institute of Chartered Accountants of England and Wales. These firms are subject to monitoring by FRC, which applies a risk-based approach in selecting individual audits for review, using a risk model covering listed and non-listed entities. This model distinguishes priority sectors, and the majority of audits selected for review are those identified as higher risk.

Sources: FRC, 2015b.

158. The frequency of reviews needs be defined. The following examples indicate how such frequency may be defined in different institutional settings where MCE is carried out.

Box 19. Examples of review frequency

In the United Kingdom, the six 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. The recognized supervisory bodies have to monitor the activities undertaken by each registered audit firm at least once every six years. In 2013, a total of 1,351 registered audit firms were monitored. The visits included requests by the registration or licensing committee, requests based on assessments of heightened risk, and requests based on random selection.

In the United States, registered firms that issue auditor's reports for more than 100 public companies and other issuers are required to be inspected annually. In 2013, the PCAOB inspected nine such firms. Registered firms that issue auditor's reports for 100 or fewer issuers are inspected at least once every three years. At any time, the PCAOB may also inspect any other registered firm that plays a role in the audit of an issuer. The PCAOB inspected 219 firms in these categories in 2013, including 53 firms located outside the United States, in 22 jurisdictions.

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

In Singapore, the four largest firms are inspected once every two years. The remaining public interest firms are generally 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; most of them conduct their operations as sole proprietorships and audit mostly small and medium-sized enterprises.

In Germany, audit firms of public interest entities (PIEs) that 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. The inspections are carried out on a random basis and without the need of a prior indication of misconduct. Audit firms are also selected on a risk basis.

In Nigeria, annual quality reviews (inspections) are conducted for professional accountants that audit more than 20 public interest entities; all others are reviewed every three years, and the Council may order a special inspection of any professional accountant at any time. The Council requires registered professional accounting firms and other professionals to maintain, for a period of not less than six years, audit work papers and other information related to an auditor's report, in sufficient detail to support the conclusion reached in the report.

Sources: Federal Republic of Nigeria Official Gazette, 2011.

4.4.2. Disciplinary action and the appeal mechanism

159. Disciplinary action and the appeal mechanism are important elements of the MCE system for auditing; the disciplinary body may be a separate panel or a tribunal or the regulator itself.

160. It is also important to define reporting procedures of audit regulators, as well as processes for the audit firm to respond to the draft inspection report, and for the issuance of a final inspection report.

161. These aspects are covered by principle 11 of the IFIAR core principles. 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. Recommendations of quality reviews must be

followed up by the auditor within a reasonable period, otherwise the auditor will be subject to disciplinary actions or penalties and sanctions, including fines, suspension, withdrawal of a licence, certification or registration; or the obligation to undertake training.

Box 20. Examples of disciplinary action

Australia: Outcomes of investigations include referral to disciplinary tribunals, a negotiated enforceable undertaking with specific requirements (e.g. cease practising for a certain period, paying compensation, or review by external consultants), instituting civil proceedings or referral to authorities for criminal prosecution.

Germany: The inspection findings are included in a non-public preliminary report sent to the audit firm for comments. The final report is then sent to the Chamber of Public Accountants, which reviews it and decides whether any breaches of professional duties have taken place. The assessment is subject to the ultimate responsibility of the Auditor Oversight Commission (APAK). Due to legal restrictions, the inspection reports are confidential and cannot be made publicly available. However, the APAK issues an annual report which provides general information regarding the overall inspection results.

Singapore: PAOC has the authority to register or unregister an auditor. Public accountants removed from the register due to disciplinary actions or failure of practice review under the Accountants Act will be listed in the public gazette, including individuals whose licences are suspended, cancelled or not renewed.

United Kingdom: Penalties include fines; censure; exclusion for a recommended period of time; withdrawal or non-reinstatement for a certain period of time of the practising certificate, registration, authorization or licence. The firm may also be required to waive/repay client fees.

United States: PCAOB prepares a report on each inspection and makes portions of each report publicly available, subject to statutory restrictions on public disclosure. In 2013, PCAOB issued 257 reports on inspections of firms that audit public companies. If an inspection report includes criticisms or identifies potential defects in a firm's system of quality control, the Board is prohibited from publicly disclosing those criticisms if the firm addresses them to the Board's satisfaction within 12 months of the issuance of the report, otherwise they are made public.

European Union: Countries are obliged to make the disciplinary sanctions imposed on statutory auditors and audit firms publicly available. Member States shall provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms. Penalties shall include the possibility of the withdrawal of approval.

The publication of issues uncovered through inspection processes also acts as a deterrent, whether they are uncovered immediately, such as in the United Kingdom, or with a delay if they remain unresolved, as is the case in the United States (one year) and in Canada (180 days).

Sources: European Parliament, 2006.

162. A critical element of the MCE system for auditing is the appeal mechanism.

163. Countries have different resources for appeal; some countries have an appeals committee, while in others an appeal must be addressed to a court.

Box 21. Examples of appeal mechanisms

In Canada, an appeals committee is appointed that includes licensees and public representatives to conduct hearings on appeals of decisions. The decision of the appeal committee, including the reasons for the decision, are provided in writing to each party, together with a notice of each party's right to appeal the decision further.

In Singapore, a public accountant who disagrees with a decision of the oversight committee may appeal to the High Court within a period of 30 days.

4.5. MONITORING ARRANGEMENTS AND IMPACT ASSESSMENT

164. The performance of the oversight of external audits should be regularly reviewed.

165. Measuring the activity of the enforcement body is a difficult if not impossible task for an outside observer. The outcomes associated with achieving objectives are largely unobservable by outside parties, often because the matter remains confidential.

Box 22. Example of effectiveness of monitoring arrangements

The FRC Monitoring Committee (United Kingdom) has shown that increases in effectiveness do not necessarily lead to input measures such as more staff or larger budgets. More generally, there is a lack of information about the cases that the regulators do not pursue and the extent to which the chances of success influence their activities.

166. However, the question of effectiveness could be addressed by considering various aspects of the MCE system for auditing, such as the number of cases pursued; the number of press notices issued; the content of decisions and their impact on companies, competitors and market prices; the timeliness of activities; and the type of remedy achieved. In addition, views of representatives of regulatory bodies, audit firms and companies subject to investigation could be considered in assessing impact.

167. An internal audit committee could provide important inputs. In evaluating the effectiveness of external audits, the audit committee assesses the effectiveness of the external audit against agreed performance criteria, including the following factors:

    (a) Overall comprehensiveness of the external audit plan;

    (b) Timeliness and quality of communications promised under the plan;

    (c) Competency of external audit staff, and the adequacy of the available resources to achieve the scope, as outlined in the plan.

168. In addition, the audit committee could obtain feedback from management and the internal audit on the conduct of the external audit.

169. To monitor how the system is improving, it is possible to implement public pronouncements or track the number and scale of audit failures.

V. MCE REQUIREMENTS FOR PROFESSIONAL ACCOUNTANTS

5.1. DEFINITION

170. Professional accountants are 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.

171. For the purposes of the International Education Standards (IESs), IAESB defines a professional accountant as an individual who achieves, demonstrates and further develops professional competence to perform a role in the accountancy profession and who is required to comply with a code of ethics as directed by a professional accountancy organization or a licensing authority.

172. Professional requirements define the necessary qualifications of accountants and appropriate professional standards in their work. MCE for accountants can include various types of activities, such as accounting, audit, tax advisory and a range of financial and other management roles. Regulation of professional accountants mainly deals with the training of professional accountants and auditors, and enhancing their compliance with the professional requirements. Such requirements are relevant in the context of this guiding document because they underpin the appropriate application of both corporate reporting and auditing good practices, thus contributing to an effective MCE system.

5.2. SCOPE AND OBJECTIVES

173. MCE for accountants covers a range of activities. Accountants in public practice may be auditors, or involved in providing tax advice or compliance services to companies.

174. MCE may be desirable in order to assess the quality of the work performed by professional accountants. However, it is important to point out that, typically, all statutory auditors are professional accountants but not all professional accountants are statutory auditors. The amount and scale of MCE is usually much more significant with regard to statutory auditors.

175. Accountants are also often employed in business in a range of financial and other management roles. MCE may be desirable, for example, for individuals in companies' financial reporting area to improve the quality of financial reporting. Regulation of individual professional accountants is primarily conducted at the national level, with professional accountancy organizations (PAOs) playing an important role in working with Governments to ensure that regulation is effective, efficient and in the public interest. Ongoing dialogue and cooperation is essential to ensure that regulation is suitably rigorous, proportionate and properly informed, and that there is an appropriate balance between self-regulation by the profession, self-regulation with public oversight and accountability, and external regulation. The extent to which the professional accounting organization is involved in the regulation of the profession will differ by jurisdiction; and in some cases that role may be very limited.

176. There is not a single preferred model, and what is appropriate for each jurisdiction will depend upon a range of environmental, historical, and cultural factors. However, whatever arrangements are in place, shared regulation might be dynamic, allowing for ongoing dialogue and alignment of actions between PAOs and governments.

177. Effective regulation needs to provide for the creation and enforcement of ethical, technical and professional standards in order to allow users (clients)s of professional services (and other non-contracting users of accountancy services, such as investors and creditors) to be confident that professional accountants have necessary qualifications and will meet the appropriate professional standards in their work.

178. An MCE system can also cover the national professional body or bodies of accountants, which will generally have responsibility for their members in respect of:

(a) Proper application of professional and ethical standards;

(b) Continuing professional development;

(c) Investigation, discipline and appeals;

(d) Qualification requirements for membership, including professional exams and practical experience;

(e) Licensing of members in public practice outside the scope of the public oversight board, (such as the audit of entities that are not deemed to be public interest entities or for services that are not audit services, including tax advice).[48]

179. The scope of MCE for professional accountants varies in different jurisdictions. In many countries, it mainly deals with training professional accountants/auditors, and with their compliance with professional requirements.

5.3. INSTITUTIONAL ARRANGEMENTS

180. Different institutional arrangements currently exist, including self-regulation by the profession through professional accountancy organizations (PAOs), self-regulation with public oversight from an independent agency of the government, and regulation by an independent external party, in which case the profession is regulated by the Government through a public or independent agency. Over time, certain regions in the world have moved from self-regulation to government regulation. Regulation through an independent agency has become more common, particularly for professional auditors.

181. In 2011, IFAC issued a position statement related to the accountancy profession, including professional accountants and auditors.[49] IFAC stressed the role of PAOs in providing assurance of the quality of services conducted by its membership. Such organizations need to promote high-quality professional practices and, where feasible, oversee the activities of their members, even when external regulation of the profession is performed by a government agency.

182. In 2004, IFAC established the seven Statements of Membership Obligations (SMOs)[50] as the foundation of the IFAC Member Compliance Programme. The SMOs were revised in 2012. They serve as a framework for credible and high-quality professional accountancy organizations focused on serving the public interest by supporting the adoption and implementation of international standards for the accountancy profession and establishing quality assurance and investigation and discipline systems. The SMOs are recognized as the international benchmarks for professional accountancy organizations; in particular, the World Bank Reports on Observance of Standards and Codes (ROSCs) for Accounting and Auditing refer to the IFAC SMOs as part of their policy recommendations to Governments and PAOs.

183. The IFAC Member Compliance Programme[51] works with PAOs around the world at various stages of development to continuously improve their efficiency. IFAC membership requirements include demonstration of compliance with Statements of Membership Obligations (SMOs); financial and operational viability; and the existence of an appropriate governance structure. IFAC Associates and Members are monitored on an ongoing basis via the Compliance Programme, under which they are required to demonstrate their efforts towards compliance with SMOs through detailed action plans. In doing so, the programme helps demonstrate maintenance of IFAC requirements and continuous progress toward strengthening of the global accountancy profession.

[48] UNCTAD, 2013a, *Accounting Development Tool: Building Accounting for Development*, United Nations publication, UNCTAD/DIAE/ED/2013/7.

[49] IFIAR, 2011, Regulation of the accountancy profession, Policy position paper No. 1, available at http://www.ifac.org/publications-resources/regulation-accountancy-profession-1 (accessed 7 February 2017).

[50] IFAC SMOs are available at www.ifac.org/system/files/publications/files/Statements-of-Membership-Obligations-1-7-Revised.pdf (accessed 7 February 2017).

[51] The IFAC Member Compliance Programme is the responsibility of the IFAC Quality and Membership staff, reporting to the IFAC CEO. The programme ooperates in accordance with the process and working procedures that have been previously agreed upon, and is overseen by the Compliance Advisory Panel, which – as one of IFAC's public interest activities – is overseen by the Public Interest Oversight Board (PIOB).

184. IFAC also undertakes a range of activities to support the development of the global accountancy profession. This includes the development of tools and guidance on good practice in fundamental areas of PAO development such as governance, advocacy and organizational structure, without which PAOs often struggle to address the technical areas covered by SMOs.

185. The PAO Development Committee of IFAC advises on IFAC work in this area, focusing on raising awareness of the success factors and challenges associated with the establishment and development of PAOs, and providing opportunities for knowledge exchange and sharing of success stories in this area.

186. In 2013, the PAO Global Development Report was published under the MOSAIC (Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration) initiative.[52] The aim of the report was to assess the status of the accountancy profession and PAOs around the world, identify recurring themes and key areas on which development efforts should focus. The report highlights, among other things, the need to support the strengthening of PAO investigation, discipline and quality assurance systems and furthering implementation of international standards (including IFRS, ISAs, and the IESBA Code of Ethics) among other things.[53]

187. The following areas of the accountancy profession require regulation as stated by IFAC:

(a) Entry requirements, initial professional development (IPD) and continuing professional development (CPD). International Education Standards (IESs), as detailed in the *Handbook of International Education Pronouncements* of the International Accounting Education Standards Board (IAESB),[54] establish requirements for entry to professional accounting educational programmes; IPD of aspiring professional accountants, and CPD of professional accountants and the professional competence for engagement partners responsible for audits of financial statements (IES 8).

(b) Ethical requirements for professional accountants. A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant might observe and comply with a code of ethics. The International Ethics Standards Board for Accountants sets ethics standards, including in relation to auditor independence requirements for professional accountants worldwide. These are compiled in the Code of Ethics for Professional Accountants.

(c) Monitoring of the behaviour and performance of professional accountants. Quality Assurance (QA) Review Systems might be in place to monitor the performance of professional accountants who, at a minimum, perform audits, reviews and other assurance and related services engagements of financial statements. The adoption of quality control standards, such as the International Standard on Auditing (ISA) 220, Quality Control for an Audit of Financial Statements and the International Standard on Quality Control (ISQC) 1, Quality Controls for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and

[52] Historic memorandum of understanding that sets out the basis for improving cooperation and collaboration between IFAC, international donors and the international development community. With 13 signatories, it provides the foundation for an aligned approach to increase the capacity of PAOs and improve the quality of financial management systems in emerging economies.

[53] IFAC, 2014a, *Professional Accountancy Organization Global Development Report*, available at https://www.ifac.org/publications-resources/professional-accountancy-organization-global-development-report (accessed 7 February 2017).

[54] IAESB is an independent standard-setting body that develops education standards, guidance and information papers for use by IFAC member bodies and other interested stakeholders in professional accounting education, such as universities and education providers, employers, regulators, government authorities, accountants and prospective accountants.

Related Services Engagements,[55] is essential to the development of a QA system. IFAC SMO 1 represents best practice requirements in establishing a QA system. QA might be linked to CPD requirements as well as to a robust investigation and discipline system.

(d) Investigation and discipline of professional accountants. A just and effective investigation and discipline system has to be in place for all professional accountants. Bodies responsible for the investigation and disciplinary system might, in their rules and regulations, provide for the investigation and discipline of misconduct, including breaches of professional standards by professional accountants and firms. IFAC SMO 6 presents best practice requirements for an investigation and discipline system for professional accountants.

5.4. BENCHMARKS

188. In building an MCE system, quality assurance mechanisms play a crucial role. In this regard, IFAC statements of membership obligations (SMOs) could be a good source of information and guidance in building such mechanisms.

189. IFAC SMO 1 requires PAOs to establish and publish quality control standards and guidance requiring firms to implement a system of quality control in accordance with the International Standard on Quality Control (ISQC) 1; SMO 1 is to be applied by member bodies of IFAC to quality assurance review programmes for their members performing certain audit engagements of financial statements. In cases where the IFAC member body is not the statutory regulator, the IFAC member body still has an obligation to use best endeavours and encourage the statutory regulator to conform to IFAC standards.

190. The implementation of standards SMO 1 and ISQC 1 requires considerable resources and expertise. If the expertise is not readily available, a significant training programme is required in order to build the required in-country expertise. In any event, the need for experts can represent a considerable financial burden on limited resources.[56]

191. Continuing professional development (CPD) reviews are beneficial for the accountancy profession as a whole, as they offer an assurance to the public that accountants are up to date with the latest industry developments and innovations.

192. There are various practices, depending on the situation with each jurisdiction and the roles played by the PAO. Typical CPD oversight includes asking relevant professional bodies to provide copies of their CPD curricula and verifying whether professional bodies have procedures to monitor compliance with CPD requirements.

Box 23. Example of CPD benchmark

In the United States, providers of CPD must be accredited by the National Association of State Boards of Accountancy. In the United Kingdom, FRC approves the CPD regulations of each of the six recognized qualifying bodies, and FRC includes monitoring to be part of its annual checks on each of recognized qualifying bodies.

193. Within the available guidelines, it is important to implement an approach to the monitoring and enforcement of requirements for professional accountants that takes into consideration the way the accounting profession is structured.

[55] ISA 220 and ISQC 1 are issued by IAASB, which is an independent standard setting body that serves the public interest by setting high-quality international standards for auditing, assurance and other related standards, and by facilitating the convergence of international and national auditing and assurance standards.

[56] UNCTAD, 2013a, *Accounting Development Tool: Building Accounting for Development*, United Nations publication, UNCTAD/DIAE/ED/2013/7.

Box 24. Example of MCE for professional requirements

In Singapore, the Accounting and Corporate Regulatory Act established the Accounting and Corporate Regulatory Authority (ACRA) as the national regulator of business entities and public accountants in the country. ACRA holds responsibility for the administration of the requirements of key legislation, for reporting to the Government on the registration and regulation of business entities and public accountants, and for the management of relevant documentation.

The Accountants Act stipulates that ACRA is specifically responsible for the registration, approval, control, and regulation of public accountants, accounting corporations, firms and limited liability partnerships. ACRA carries out these duties through PAOC. The Accountants Act and the Accountants Rules outline the requirements related to the following points:

- Registration of public accountants. This covers, among other things, education requirements before and after certification, practical experience requirements, continuing professional education, and requirements for membership of the Institute of Singapore Chartered Accountants;
- Code of Professional Conduct and Ethics. All registered public accountants and accounting entities must observe the Code of Professional Conduct and Ethics prescribed in the law and other pronouncements issued by PAOC;
- Quality assurance review. Public accountants are required to comply with auditing standards and professional and technical pronouncements issued or adopted by PAOC, and adherence to these requirements is reviewed under the Practice Monitoring Programme;
- Disciplinary procedures. Complaints received regarding improper conduct are to be investigated and reviewed by the Complaints and Disciplinary Panel of the PAOC. The PAOC is the final authority on all findings and recommendations.

The Accounting Standards Council, established by the Accounting Standards Act, issues Singapore Financial Reporting Standards, while the Singapore Accountancy Commission (SAC), established as a statutory body of the Government of Singapore, oversees the strategic direction and promotion of the accountancy sector in Singapore. The use of the “Chartered Accountant of Singapore” designation is protected under part VII of the SAC Act, which outlines, among other things, that all CA candidates are required to be members of the Institute of Singapore Chartered Accountants and to meet the Institute’s standards of professional conduct.

The majority of ACRA board members are non-practitioners appointed by the Minister of Finance and are independent from the auditing profession. ACRA is self-funded, with most of its income coming from statutory fees. ACRA is a member of the International Forum of Independent Audit Regulators and the ASEAN Audit Regulators Group.

5.5 MONITORING ARRANGEMENTS AND IMPACT ASSESSMENT

194. The efficiency of activities undertaken by professional accountancy organizations is critical. In this regard, a number of tools and reference points are currently available.

195. The Accounting Development Tool contains indicators and related questions to assess the level of PAO development, including enquiries regarding the existence of a professional accountancy organization in the country; membership of the International Federation of Accountants; coordination mechanisms; the ability of professional accountancy organizations to comply with the Statements of Membership Obligations, including the sufficiency of human and financial resources; the existence of a code of ethics that is up to date; and investigations, discipline and appeals, including the independence of committee members.

196. The Confederation of Asian and Pacific Accountants has published a maturity model for the development of professional accountancy

organizations,[57] a framework created to help PAOs undertake an organizational self-assessment and identify opportunities for development and improvement. The purpose of this document is to assist in the development of PAOs, irrespective of their current stage of advancement. It provides a road map for organizational growth, based on the measurement and improvement of practices and processes. The model includes considerations around a PAO's role in the regulatory framework, including the establishment of standards and systems to monitor the quality of services provided by PAO members to the public, and appropriate handling of complaints of misconduct.

197. IFAC has a PAO capacity-building framework to support its work in the identification of opportunities for development of PAOs across the full range of their activities.

198. The framework identifies nine interrelated elements that a PAO must address if it is to be successful and, among other things, to be in a position to comply with the IFAC Statements of Membership Obligations.

199. The nine elements are organized under three key pillars that relate to a PAO's operational sustainability, its relevance to members and the public, and its approach to standards and their enforcement. The framework outlines good practice principles in each of these areas, allowing for a qualitative assessment of a PAO according to each element.

200. The elements cover the following areas:

(a) Sustainability: Appropriate legal foundations, governance structure, and operational capacity;

(b) Relevance: Responding to the needs of a PAO's membership and connectivity to broader society across the private and public sectors;

(c) Standards and enforcement: Adoption and implementation of international standards in education, ethics, accounting and auditing, and monitoring and enforcing compliance with these standards.

[57] CAPA, 2014, *Maturity Model for the Development of Professional Accountancy Organizations*, available at http://www.capa.com.my/images/capa/CAPA_MaturityModel_2014_FINAL_S.pdf (accessed 7 February 2017).

IFAC PAO CAPACITY-BUILDING FRAMEWORK

Sustainability	*Relevance*	*Standards and enforcement*
Legal and regulatory framework	Value to members and students	Education, training and professional qualification
Institutional and managerial capacity	Value to stakeholders	Adoption and implementation of international standards in accounting, auditing and ethics
Intellectual and professional capacity	Value to society	Monitoring and enforcement

ANNEX I. INTERNATIONAL STANDARDS

A. ACCOUNTING STANDARDS

1. The International Accounting Standards Board (IASB) develops global accounting standards and related interpretations, collectively known as IFRS. These standards are intended to be used for the preparation of general purpose financial statements. Regulators for specific sectors may have their own reporting requirements that differ from or supplement IFRS (or they may use IFRS, but require additional disclosures), particularly with regard to banks, insurance companies and taxation.

2. Accounting frameworks also exist for sector-specific reporting, including IFRS for SMEs and International Public Sector Accounting Standards (IPSAS). Both of these sets of standards use IFRS as a foundation.

3. IOSCO has also published principles and standards on the disclosures in cross-border offerings and listings of debt securities by foreign issues,[1] as well as ongoing and periodic disclosures by listed entities.[2]

B. ENVIRONMENTAL, SOCIAL AND GOVERNANCE DISCLOSURE STANDARDS AND GUIDELINES

4. At the current stage, disclosure on a range of environmental, social and governance (ESG) issues is the subject of a number of voluntary international best practice guidelines. A national framework to address ESG issues can benefit from international best practice guidance, as well as international networks and management systems standards. Reporting on environmental and social issues provides useful information to a range of key stakeholders, including government regulators, investors, business partners, employees and the local community.

5. A number of international guidelines can assist countries in developing a reporting framework in this area:

   (a) The United Nations Conference on Trade and Development has developed guidance to assist countries in this regard, including guidance on eco-efficiency indicators[3] and corporate responsibility indicators in annual reports.[4]

   (b) The Global Reporting Initiative[5] has developed sustainability reporting guidelines that cover a broad range of social and environmental subjects.

   (c) Both the Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises[6] and the International Organization for Standardization (ISO) 26000 standard[7] on social responsibility contain useful guidance on environmental and social reporting and management practices.

   (d) An environmental management system standard, such as ISO 14000, can also be helpful in providing guidance on internal reporting and data collection.[8]

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[1] IOSCO, 2007, *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf; and IOSCO, 1998, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf (accessed 7 February 2017).

[2] IOSCO, 2002b, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf; and IOSCO, 2010, Principles for Periodic Disclosure by Listed Entities, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf (accessed 7 February 2017).

[3] UNCTAD, 2004, *A Manual for the Preparers and Users of Eco-efficiency Indicators*, United Nations publication, UNCTAD/ITE/IPC/2003/7.

[4] UNCTAD, 2008, *Guidance on Corporate Responsibility Indicators in Annual Reports*, United Nations publication, UNCTAD/ITE/TEB/2007/6.

[5] For more information on the Global Reporting Initiative and to obtain a copy of their *Sustainability Reporting Guidelines*, see www.globalreporting.org (accessed 7 February 2017).

[6] Available at http://www.oecd.org/corporate/mne (accessed 7 February 2017).

[7] The ISO guidance standard on social responsibility was published in 2010 as ISO 26000, and its use is voluntary. It will not include requirements and will thus not be a certification standard. For more information, see www.iso.org/sr (accessed 7 February 2017).

[8] More information on the range of ISO environmental management system standards is available at www.iso.org/iso/iso_14000_essentials (accessed 7 February 2017).

(a) The United Nations Global Compact also has a reporting framework that allows companies to report on their activities relative to the 10 principles of the Global Compact on environmental, social, anti-corruption and anti-bribery and human rights issues.[9]

(b) Disclosure on governance structures are critically important for facilitating investor relations, promoting economic stability and building credibility in the governance and management systems that produce financial accounting reports.

6. International guidance in this area is provided by a number of organizations, including the OECD *(Principles of Corporate Governance)*,[10] the World Bank (ROSC reports and other guidance),[11] the International Finance Corporation (especially the work of the Global Corporate Governance Forum),[12] IOSCO (various guidance documents and support for the development of securities regulators), the International Corporate Governance Network (Global Corporate Governance Principles) and UNCTAD (Guidance on Good Practices in Corporate Governance Disclosure[13] and reviews of corporate governance disclosure practices and regulation).[14] In public sector accounting, IFAC and the Chartered Institute of Public Finance and Accountancy (CIPFA) have also issued relevant guidelines (International Framework: Good Governance in the Public Sector).[15] Newer institutions are also emerging (for example, the International Integrated Reporting Committee and the Carbon Disclosure Standards Board), which aim to promote the harmonization of ESG standards and the integration of ESG issues into corporate reporting. National frameworks can use the guidance offered by these organizations as a basis for the development of their own national corporate governance codes and disclosure regulations.

C. AUDITING AND ASSURANCE STANDARDS

7. One of the common aspects of some countries that have implemented IFRS is the requirement to conduct the audit of IFRS financial statements in accordance with the International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board. International Standards on Auditing can be an important tool in enforcing the proper implementation of IFRS. Guidance for the application of ISA for SMEs is available from the IFAC Small and Medium-sized Practices Committee.[16] The Public Interest Oversight Board provides oversight of the ISAs and ensures that they are developed with the public interest in mind.

8. Other sources of international principles, standards and guidance on accounting, auditing and regulation include:

(a) IOSCO “Objectives and principles of securities regulation”,[17] and related assessment methodology;

[9] The Global Compact publishes a number of guidance materials to assist companies in producing a “Communication on progress” with the 10 principles of the Compact. These guidance materials are available at https://www.unglobalcompact.org/participation/report/cop (accessed 7 February 2017).

[10] OECD, 2015, *Principles of Corporate Governance*, available at http://www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm (accessed 7 February 2017).

[11] As part of the ROSC initiative, the World Bank has established a programme to assist its member countries in strengthening their corporate governance frameworks. The World Bank conducts corporate governance country assessments under the ROSC initiative at the invitation of country authorities. More information on this programme is available at http://www.worldbank.org/en/programs/rosc#2 (accessed 7 February 2017).

[12] The Global Corporate Governance Forum supports regional and local initiatives to improve corporate governance in middle and low-income countries, in the context of broader national or regional economic reform programmes. More information on this programme is available at www.gcgf.org (accessed 7 February 2017).

[13] UNCTAD, 2006, *Guidance on Good Practices in Corporate Governance Disclosure*, United Nations publication, UNCTAD/ITE/TEB/2006/3.

[14] UNCTAD, 2011, *Corporate Governance Disclosure in Emerging Markets*, United Nations publication, UNCTAD/DIAE/ED/2011/3.

[15] IFAC, 2014b, *International Framework: Good Governance in the Public Sector*, available at https://www.ifac.org/publications-resources/international-framework-good-governance-public-sector (accessed 7 February 2017).

[16] IFAC, 2011b, *Guide to Quality Control for Small and Medium-sized Practices*, available at http://www.ifac.org/publications-resources/guide-quality-control-small-and-medium-sized-practices-third-edition-0 (accessed 7 February 2017).

[17] IOSCO, 2010b, *Objectives and Principles of Securities Regulation*, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf (accessed 7 February 2017).

(b) Other IOSCO principles, statements and reports relating to financial reporting, auditing, internal control, auditor oversight and governance matters;

(c) Basel Committee principles, standards and guidance on corporate governance, accounting, auditing and disclosure (including valuation and provisioning) are particularly relevant for the supervision of banks;

(d) Extensible Business Reporting Language (XBRL), which provides a global standard for the exchange of financial information;

(e) International Association of Insurance Supervisors, which provides principles, standards and guidance particularly relevant to insurers;

(f) International Organization of Supreme Audit Institutions,[18] which provides guidance and standards particularly relevant to accounting and auditing in the public sector.

9. Regional and national sources include:

(a) European Union Directive 2014/56 and Regulation 537/2014 on Statutory Audits;[19]

(b) Sarbanes Oxley Act in the United States;

(c) Committee of Sponsoring Organizations of the Treadway Commission model on internal controls;[20]

(d) National banking codes;

(e) Institute of Internal Auditors' standards and guidance on internal audit.

[18] See http://www.intosai.org (accessed 7 February 2017).

[19] European Commission, Directives and Regulations, available at http://eur-lex.europa.eu/homepage.html (accessed 7 February 2017).

[20] See http://www.coso.org (accessed 7 February 2017).

D. PROFESSIONAL ACCOUNTANT REQUIREMENTS

10. The accountancy profession is one of the key institutional players of the capacity-building framework. In this regard, a well-organized and respected professional body is an essential part of a fully functioning accountancy profession. Setting up or developing a professional body requires a structure that involves consideration of a large number of matters. Detailed guidance on setting up a professional body can be found in the IFAC toolkit, Establishing and Developing a Professional Accountancy Body.[21] Practices vary from complete self-regulation by PAOs, to such organizations becoming in effect agencies of government.

11. International standards related to PAOs include:

(a) International Ethics Standards for Accountants;

(b) International Code of Ethics for Professional Accountants (including independence);[22]

(c) IAASB ISQC 1 on quality control of audit and assurance engagements;[23]

(d) IFAC SMOs.[24]

[21] IFAC, 2011c, *Establishing and Developing a Professional Accountancy Body*, available at http://www.ifac.org/publications-resources/establishing-and-developing-professional-accountancy-body

[22] IESBA, 2016, *Section 290.6 of the Code of Ethics*, available at http://www.ethicsboard.org/iesba-code (accessed 7 February 2017).

[23] IFAC, 2015, *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements,* available at https://www.ifac.org/publications-resources/2015-handbook-international-quality-control-auditing-review-other-assurance (accessed 7 February 2017).

[24] IFAC, 2012, *Statements of Membership Obligations (Revised)*, available at https://www.ifac.org/system/files/publications/files/Statements-of-Membership-Obligations-1-7-Revised.pdf (accessed 7 February 2017).

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