

BASEL COMMITTEE ON BANKING SUPERVISION

Via fax: +1 212 286 9570

Mr Manuel Sanchez y Madrid
Chairman
IAPC Review Task Force
International Federation of Accountants
535 Fifth Avenue, 26th Floor
New York, New York 10017 USA

21 September 2001

Re: Report and Recommendations from the IAPC Review Task Force

Dear Mr Sanchez,

The Basel Committee is pleased to have been offered the opportunity to comment on the review of the operations of the IFAC International Auditing Practices Committee. We believe that the report discusses a number of relevant aspects of and provides many constructive recommendations on the important issue of international standard setting in the audit area.

Please find our detailed comments in the attached note. The note has been prepared by the Committee's Accounting Task Force, chaired by Prof Arnold Schilder, Executive Director of De Nederlandsche Bank.

If you have any questions regarding our comments, please feel free to contact Prof Schilder (+ 31 20 524 3360) or Bengt A Mettinger at the Basel Committee Secretariat (+ 41 61 280 9278).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'William J. McDonough', written in a cursive style.

William J McDonough

Annex

“Review of the operations of the IFAC International Auditing Practices Committee”

Report issued for public comment 18 July 2001

General comment

Independent high quality audits of financial statements are an important part of the functioning of capital markets generally and the financial system in particular. The audit function serves not only shareholders and potential investors but also other stakeholders and the public in general by enhancing credibility in publicly presented financial information.

The auditing profession has developed significantly over the last few decades. The continuously increasing complexity of financial accounting and reporting standards and of the types of commercial transactions frequently entered into, the dependency of business enterprises on modern information technology and the size, complexity and truly international character of numerous enterprises has called for significant professional development. There is no doubt that the resulting professional development in many countries often has been impressive.

However, the factors enumerated above and the increase in global business enterprises in particular have also caused a very significant concentration of auditing firms so that today mainly five very large auditing firms operate globally. At the same time, competition between firms has increased considerably. Competitive bidding for audit assignments is now common in many countries. Also, the auditing firms have developed significant consultancy arms aiming at serving audit clients as well as other customers.

Given this environment, high quality standards for audit and enforcement of these standards are crucial. Given in particular the internationalisation of financial markets, there is a strong call for high quality international standards on auditing.

The terms of reference for the task force's review of the IAPC operations include having the IAPC remain an IFAC committee, i.e., one component of a self-regulatory regime. In our opinion, this underlines the importance of making the greatest possible use of opportunities to strengthen the independence and transparency of the standard setting process.

Other ongoing IFAC changes

The review presented in the report is a part of the project to improve financial reporting and auditing and promote the credibility of financial reports. The other parts of this project consist of the establishment of the Forum of Firms to promote consistently high standards of financial reporting and auditing world-wide and the Transnational Auditors Committee, both of which are operating on a provisional basis, and the creation of a Public Oversight Board. These changes were recently presented in separate documents, which include a detailed Constitution and Operating Procedures (for the Forum of Firms) and a Charter (for the Public Oversight Board).

An essential aspect of all the proposed changes is to promote public confidence in auditing and audited financial statements. Given this, it is somewhat unfortunate that IFAC is consulting on the future of the IAPC before consulting on the establishment of the Public Oversight Board and the other components of its project.

Auditing is a public interest activity

The report emphasizes that auditing is a public interest activity, as it "provides assurance to those who use audited financial statements that an independent professional has performed sufficient work to express an opinion on the fair presentation of those statements." We fully endorse this view. It is important that the public interest be explicitly referred to in the charters and constitutions of the various entities that are part of the self-regulatory regime for the international auditing profession. However, it is even more critical that the public interest be internalised in the culture of international audit standard setting.

Should regulators be represented on the IAPC?

The report raises the question of whether regulators should be represented on the IAPC. It concludes that they should not. We agree with the report's conclusion that regulators should not be members of the IAPC, as this may bind the regulators into the output of the IAPC and make it more difficult for them to fill their role of considering objectively the quality of the output of the IAPC and making objective recommendations.

We do, however, believe that there is a significant difference between having regulators serve as voting members of the IAPC and allowing regulators to follow closely the work of the IAPC and its subcommittees as observers. In our view, observer status provides the IAPC and its subcommittees with the benefit of regulatory input and the regulators with excellent insights into the ongoing work, facilitating subsequent assessment of the output of the IAPC. The report notes that the regulators and the Public Oversight Board should be encouraged to observe and oversee the activities of the IAPC. We support this view and recommend that regulators be invited to take part as observers in the IAPC and in its subgroups and working groups. The Basel Committee, being a committee on banking supervision, would on a selective basis react favourably to such an invitation.

Selection and composition of the IAPC

The report suggests three basic criteria for members to be appointed to the IAPC:

- Best person
- Country balance
- Firm balance

We support the suggested criteria. Understandably, the report pays particular interest to how the auditor members of the IAPC should be selected, and discusses this in terms of countries and firms. Concerning the objective of achieving firm balance we want to underline the merits

of including members from firms outside the big five. We also support the objective of ensuring strong links with national standard setters. IFAC may wish to consider whether there are aspects of the IASB's structure and governance that might usefully be adapted to the IAPC.

The report suggests a slight increase in the number of members of the IAPC, from 14 to 15. We believe that this change is reasonable.

The terms of reference for the review stated that the setting of ISAs should remain in the hands of the IAPC, as a committee of IFAC. The report is nevertheless willing to accept that non-auditors can be appointed to the IAPC. It suggests that, out of the 15 members, 3 could be non-auditor members, and points out as potential sources:

- Academics
- Users of financial reports
- Public sector representatives

The report also states that searching for non-auditor members should be a task for the Nominating Committee.

We support the proposal to include non-auditors on the IAPC. However, we do not support the idea that the number of non-auditors can be reduced to zero if candidates are not available. The rule should be that a certain number of non-auditor members, at least 3, should be appointed. We would also like to suggest that IFAC consider having the non-auditor members be appointed by bodies that do not represent the accountancy profession.

International Auditing Practice Statements

The report recommends that the review and approval process for practice statements be streamlined in order to improve efficiency. However, the report does not specify what such streamlining would entail. We note that an adequately designed due process is useful not only for the efficiency of the development of standards and guidance, but also for their acceptance.

The consultative process

The report does not discuss or suggest any minimum length of time for the publication of consultative documents. We believe that such a minimum, for example three months, should be established.

Transparency

One of the most important recommendations in the report is that the meetings of the IAPC should be public, and that agenda papers should be publicly released two weeks before the meetings. We believe this is a useful measure to increase transparency and enable interested parties to follow the process.

Role of National Standard Setters

The report advocates a flexible approach, and enumerates various measures that can be taken to strengthen the links with national standard setters. We support the approach taken.

Charter for the IAPC

We are not aware that a charter exists for the IAPC, and the report does not suggest that one should be established. Given that the aim for several important measures is to improve public confidence in auditing standards and the standard setting process, we believe that a charter should be elaborated, formally delineating the rules under which the IAPC operates.

Nominating Committee

As issues relating to the Nominating Committee were not included in the Task Force's terms of reference, the work of the Nominating Committee and how it is selected are not considered in the report. Somewhat unfortunately, neither is this subject dealt with in the other parts of the consultative packages.

Participation in subcommittees

One comment in the report gives the impression that only IAPC members and technical advisors will participate in the IAPC subcommittees. This does not seem to be a meaningful restriction. As mentioned above, we believe that allowing regulators to participate in subcommittees as observers would be mutually beneficial.

Liaison with the IASB

The report mentions that the IASB is represented on the Consultative Advisory Group. We believe that International Accounting Standards constitutes an important point of reference in the development of auditing standards, and recommend that frequent contacts with IASB should be encouraged.