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1 Regulatory Environment

IMPORTANCE OF ASSURANCE SERVICES

Assurance professionals play a key role in providing **independent opinions** on whether financial and non-financial information meets specific standards. Their reports help users of that information **trust its accuracy and reliability**, allowing them to make informed decisions.

In financial markets, investors need **accurate and trustworthy information** to decide whether to **buy or sell shares**. If the information is unreliable, investors may struggle to make the right decisions.

It's not just investors who rely on assurance services—**many other stakeholders** also depend on them. For example:

- **Banks** often require audited financial statements and verified financial forecasts before approving loans.
- **Businesses** may request audited reports before entering into agreements with suppliers or customers.
- **Employees, suppliers, and lenders** need financial information to assess risks before making major decisions.

Without assurance services, **stakeholders could face financial risks** due to incorrect or misleading information. By ensuring financial transparency, assurance professionals help build confidence in business decisions and the overall economy.

REGULATION OF THE ACCOUNTING PROFESSION

UNDERSTANDING REGULATION

In earlier studies of **Audit and Assurance**, students learned the basics of how the accounting profession is regulated. At the **Advanced Audit and Assurance** level, we explore this topic in more detail, focusing on the global impact of regulation.

Over the years, **financial scandals** have raised public concerns and led to major changes in the way auditing and accounting are regulated worldwide. Some key developments include:

- **International Standards on Auditing (ISAs):** These have been adopted by over 100 countries, ensuring consistency in how audits are conducted globally. The World Federation of Exchanges also supports these standards.
- **International Code of Ethics (IESBA):** Many professional accounting bodies follow these ethical guidelines to ensure accountants act with integrity.
- **New Corporate Governance Laws:** Laws like the **Sarbanes-Oxley Act (SOX) in the US** were introduced to improve financial reporting and auditing standards. SOX also created the **Public Company Accounting Oversight Board (PCAOB)**, which monitors the quality of audits for listed companies.
- **Public Interest Oversight Board (PIOB):** Established in 2005, this body supervises the standard-setting activities of the **International Federation of Accountants (IFAC)** to ensure accountability and compliance.

WHY REGULATION IS IMPORTANT

When **large businesses collapse**, especially well-known companies, **investor confidence drops**, and financial markets can become unstable. People rely on **accurate financial reports** to make investment decisions, and poor auditing can lead to misleading information.

To prevent this, **independent and high-quality auditing is crucial**. However, several corporate failures have damaged trust in auditors, leading to increased regulation in the profession.

SELF-REGULATION VS. EXTERNAL OVERSIGHT

In the past, accountants **regulated themselves**, setting their own financial reporting and auditing standards. This made sense because accounting organizations aimed to serve the **public interest** and had the expertise to establish fair rules.

However, major corporate scandals like **Enron** showed that self-regulation was not enough. Governments and independent bodies had to step in to strengthen rules and oversight.

1. **The Financial Action Task Force (FATF)7**

   The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 to develop and promote policies aimed at combating money laundering and terrorist financing. FATF sets international standards and encourages effective implementation of legal, regulatory, and operational measures for combating these threats to the integrity of the international financial system.

   FATF's relevance to the accounting profession lies in its guidance for accountants and auditors to identify and mitigate risks related to money laundering and terrorist financing. This includes implementing customer due diligence measures and reporting suspicious transactions, thereby contributing to global financial security.

2. **International Accounting Standards Board (IASB)**

   The International Accounting Standards Board (IASB) is an independent, privately funded organization based in London, UK. Comprising members from diverse countries and professional backgrounds, the IASB is committed to developing a single set of high-quality, understandable, and enforceable global accounting standards. These standards aim to provide transparent and comparable information in general-purpose financial statements.

   The IASB collaborates with national accounting standard-setters to achieve convergence in accounting standards worldwide. It is responsible for developing and approving International Financial Reporting Standards (IFRS), which are utilized by numerous countries to ensure consistency and transparency in financial reporting.

(ADD these two topics just above the need for global regulation)

The Need for Global Regulation

With businesses expanding across countries, differences in **local laws and regulations** created challenges. Companies operating in multiple countries had to follow **different auditing rules**, making financial reporting complicated.

To address this issue, the **International Federation of Accountants (IFAC)** was established to promote global consistency in accounting and auditing standards. This helps multinational companies and professionals work more efficiently across borders.

By improving regulation, the accounting profession aims to **restore trust, protect investors, and ensure financial stability worldwide**.

Corporate governance refers to the **framework of rules, procedures, and practices** through which a company is **managed and monitored**.

It ensures that publicly listed companies operate in a **responsible and transparent manner**, aiming to protect the **interests of shareholders and the business as a whole**.

Corporate governance frameworks often **evolve in response to corporate misconduct**, where unethical management may have:

- **Manipulated stock prices** for personal enrichment
- **Concealed weak performance or poor management decisions**
- **Misappropriated company resources** for personal use
- **Engaged in fraudulent financing activities**

THE INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

- **Established:** 1977
- **Headquarters:** New York
- **Members:** Over 180 organisations (including ACCA) from 130 countries, representing around 3 million accountants.

MISSION OF IFAC

To **serve the public interest** and **strengthen the global accountancy profession** by:

- Promoting **high-quality professional standards**
- Supporting **strong international economies**

STRUCTURE OF IFAC

- **IFAC Council:** One representative from each member body; meets once a year and elects the Board.
- **IFAC Board:** Sets policy and supervises committees.
- **Nominating Committee:** Suggests who should serve on boards, groups, and task forces.

KEY IFAC BOARDS AND GROUPS

1. **IAASB (International Auditing and Assurance Standards Board)**
   - Develops **International Standards on Auditing (ISAs)** for consistent auditing practices worldwide.
2. **International Ethics Standards Board for Accountants**
   - Promotes and updates the **Code of Ethics**, addressing ethical challenges faced by accountants.
3. **Transnational Auditors Committee & Forum of Firms**
   - Encourages members to follow global standards for high-quality international audits.

Other Advisory Groups

- **PAO Development & Advisory Group** (for professional bodies)
- **Accounting Education Standards Advisory Group**
- **Professional Accountants in Business Advisory Group**
- **International Public Sector Accounting Standards Board**
- **Small and Medium Practices Advisory Group**

CHALLENGES FACED BY IFAC

- Funded and managed by the profession itself – seen as **self-regulation**, which some believe is not ideal for audit regulation.
- **National differences** slow down the adoption of global standards.
- **Big firms** have more influence than some member bodies, reducing the authority of professional organisations.

CORPORATE GOVERNANCE

Corporate governance refers to the **framework of rules, practices, and procedures** that guide how a company is run and controlled.

It aims to make sure that **public companies are managed properly**, focusing on what's best for the company and its shareholders.

WHY IS CORPORATE GOVERNANCE IMPORTANT?

Corporate governance often comes into focus after corporate scandals, where dishonest management has:

- **Manipulated stock prices** for their own benefit
- **Hid losses or poor performance** from stakeholders
- **Taken money** out of the company for personal use
- **Obtained funds** through **fraudulent methods**

UK CORPORATE GOVERNANCE CODE

The **OECD (Organisation for Economic Co-operation and Development)** created **six key principles** to help countries build strong corporate governance systems. These principles are meant to guide lawmakers when developing company regulations.

OECD'S SIX PRINCIPLES OF CORPORATE GOVERNANCE

1. Build a strong and effective corporate governance system
2. Protect shareholders' rights and treat them fairly
3. Ensure proper conduct by investors, stock markets, and financial intermediaries
4. Recognize the role of stakeholders (like employees, suppliers, and communities)
5. Promote openness and honesty through **transparency and disclosure**
6. Define the responsibilities of the **board of directors**

How the UK Follows These Principles

The **UK Corporate Governance Code** is based on these OECD principles and applies mostly to **publicly listed companies** — where many people and institutions invest their money, such as small investors and pension funds.

Since these companies influence the economy, good governance is essential.

THE UK CODE COVERS FIVE KEY AREAS

1. **Board Leadership & Purpose** – The board should set the company's vision and values
2. **Division of Responsibilities** – Clear roles between the board chair, CEO, and other directors
3. **Board Composition & Evaluation** – Having the right people, succession planning, and regular performance reviews
4. **Audit, Risk & Internal Controls** – Managing risks and ensuring financial integrity
5. **Remuneration** – Fair and appropriate pay for directors and executives

FLEXIBLE, NOT RIGID

The Code doesn't enforce strict rules. Instead, companies must **follow the principles** or **explain why they don't** ("**comply or explain**" approach). This allows flexibility while promoting accountability.

1. BOARD LEADERSHIP AND COMPANY PURPOSE

Main Ideas

- A good company has a strong board that thinks about long-term success and value for shareholders.
- The board should set the company's purpose (why it exists), values (what it believes in), and strategy (how it will succeed).
- Directors should lead by example and support a positive company culture.
- The board must make sure the company has the right people, money, and tools to reach its goals.
- It should create strong systems to manage risks and work well with both shareholders and stakeholders (anyone affected by the company).
- Employees should be treated fairly and allowed to share concerns safely and confidentially.

Key Practices

- The board must explain in the annual report how it plans for future risks and opportunities.
- If more than 20% of shareholders vote against a proposal, the board must explain what it will do about it.
- Employees can raise issues anonymously (whistleblowing).
- Directors should record any serious concerns, especially if they resign due to issues.

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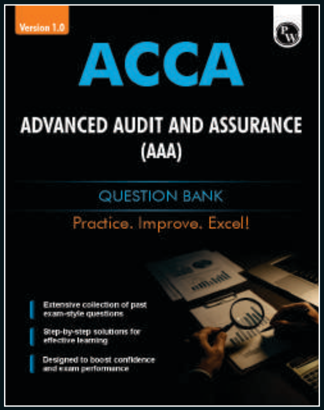

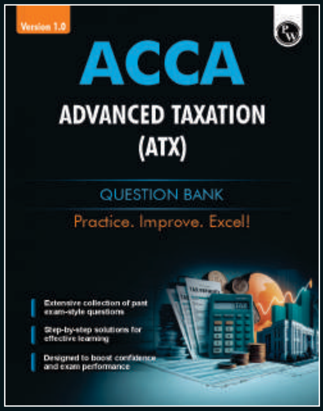

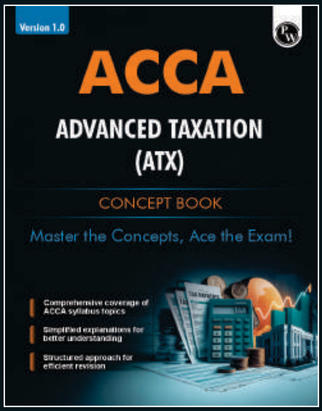

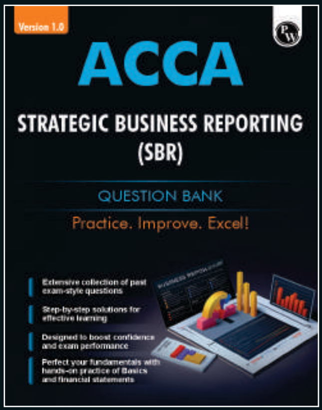

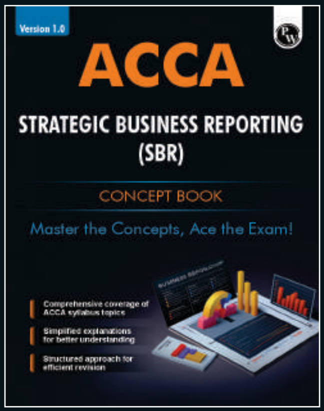

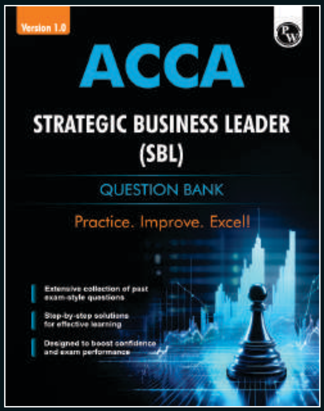

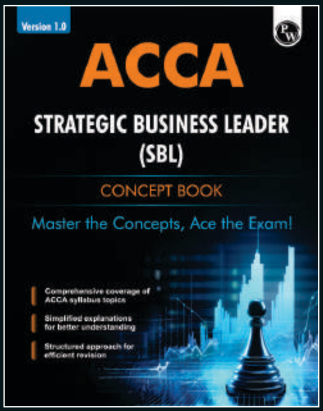

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