



Regulation of the Accountancy Profession



**The Institute of
Chartered Accountants
of Pakistan**

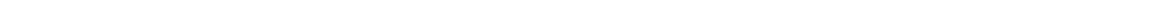
Member's Information & Education Series

MIES - 18



Contents

Foreword	5
Introduction	7
SAFA Report for the Regulation of Accounting Profession in the Region	9
IFAC Position Paper for Regulation of the Accountancy Profession	23



Foreword

I am pleased to present the eighteenth booklet under the Members' Information and Education Series (MIES-18) on the subject of **“Regulation of the Accountancy Profession”**.

The booklet contains a paper developed by SAFA on Oversight Arrangements in South Asia and also contains a policy position paper issued by the International Federation of Accountants (IFAC) on the subject.

International debate on the issue of oversight arrangement arose after the Enron debacle in the USA. The primary concern at that point in time was status of practicing members of AICPA and their regulatory framework with reference to SEC-USA and AICPA which is a private body.

In contrast to AICPA, ICAP has since inception been a statutory body formed under Chartered Accountants Ordinance, 1961. It is governed by the Council that includes members nominated by the Federal Government. Presently four out of total sixteen members are Government nominees. ICAP Council always worked very closely with SECP and SBP. In fact a joint co-ordination committee of the ICAP and SECP regularly meets to deliberate on issues related to the profession for consideration and approval of the ICAP Council.

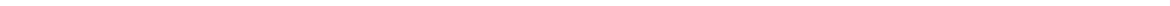
ICAP has implemented a mandatory Quality Control Review Program since 1999 that requires all firms to undergo review of the working papers, and any firm that does not receive satisfactory rating is not qualified to be appointed as auditor of a listed company. Due to enforcement of this system, 100 firms are qualified to carry out audit of listed companies. Further, ICAP has also suggested changes in Chartered Accountants Ordinance to strengthen its investigative and quality control process.

It is expected that you will find the booklet useful and informative.

I am thankful to Mr. Shabbar Zaidi, President SAFA, past President ICAP and my colleague at the Council of the Institute for his efforts in compiling this valuable paper for SAFA on 'Oversight Arrangements with reference to ROSC' and IFAC for granting permission to reproduce their policy position paper on the captioned subject and the editorial team at ICAP for their assistance and support in publishing it.

Imran Afzal
President ICAP

May 30, 2008



Introduction

Public oversight is a major element in the maintenance of confidence in the audit function. The present erosion of confidence is partly based on a public perception that any self-regulating profession runs a risk of conflicts of interests in dealing with its shortcomings.

The World Bank during their ROSC studies on Accounting and Auditing carried out in 2005, in every country's report of the South Asian region strongly recommended for creation of independent oversight boards on the pattern of USA and UK.

SAFA represents the region having largest number of professional accountants in the world. In order to address the issue of independent oversight boards as suggested in the ROSC reports, SAFA established a working group to review the existing regulatory models of the world and recommend a model for the SAFA region in particular and the rest of the world in general.

Since the ROSC reports were developed by the World Bank, therefore significant importance is being assigned for its implementation. In this situation, SAFA finalized a strong unanimous view and strategy to be furnished to the respective Governments. This issue crops up regularly which requires a definitive statement by SAFA for a model regulatory framework for the accounting profession. This publication is the first step towards this exercise.

I am extremely thankful to SAFA for entrusting this huge responsibility upon me. It is expected that all the professional accounting bodies in the South Asia region and the remaining world will take benefit from the above study of SAFA. I look forward to hearing constructive suggestions for improvement in the model recommended by SAFA.

Syed Mohammad Shabbar Zaidi

President

South Asian Federation of Accountants (SAFA)



**South Asian Federation of Accountants
(SAFA)**

**Report of the
Committee for the Regulation of
Accounting Profession in the Region**

Prepared by

Syed Mohammad Shabbar Zaidi
Chairman



Preamble

This represents the final draft of the report by the Task Force for the Regulation of Accounting Profession as constituted in the 60th SAFA Assembly meeting at Karachi held on April 18, 2006. The Committee is chaired by Syed Mohammad Shabbar Zaidi from Pakistan. Heads of the public accounting bodies of the region are the members of the Committee. Two detailed sessions were held for deliberations on the subject in Dacca and Chennai. The draft report was approved in the 63rd SAFA Assembly meeting held at Kathmandu on December 18, 2006.

Contents of the Report

This report consists of the following segments:

1. Need for SAFA's Deliberations on the Subject
2. Historical Perspectives of the Development of Accounting and Auditing Profession in the Region
3. Practices Prevalent in the Region
4. Public Interest and Socio-Economic Condition in the Region
5. Models for the Regulation of Auditing Profession
6. General Quality of Governance-Capacity of the Regulators
7. Oversight and Regulation-Functions Perceived to be Undertaken
8. Recent Initiatives in Various Countries of the Region
9. Strategy and Suggestions
10. Conclusion

Need For SAFA's Deliberations on the Subject

During the Karachi session of the SAFA, the President of the Institute of Chartered Accountants of Bangladesh, Mr. A S M Nayeem informed the session that there have been certain developments in Bangladesh on the matter of oversight arrangement for auditing profession as a result of which a statute has been placed before the parliament of Bangladesh that suggests formation of a Financial Regulatory Authority. As per the Bangladesh Institute (ICAB) this step is not in line with the views of ICAB on this matter and it has reservations about the future role of the proposed institution. ICAB further informed that this step has been undertaken as a consequence of implementation of the World Bank's Report on Observance of Standards and Codes- Accounting and Auditing (ROSC). ICAB solicited SAFA's support and deliberations on the matter, since this issue, now being raised in Bangladesh, is also emerging in other countries of the region. Accordingly it is in the interest of SAFA to take this under consideration and come up with certain broad policy approach and guideline on the subject.

It is also worth mentioning that similar exercises on ROSC were also conducted in Pakistan and India. Subsequent to the release of ROSC report in Pakistan the Securities & Exchange Commission of Pakistan (SECP) desired deliberations on the matter and suggested certain actions on that account. ICAP presented its views to the SECP and the contention of ICAP has, in principle, been considered to be relevant.

The Committee was therefore constituted to examine the issue and to lay down broad guidelines on the subject. The primary terms of reference therefore required study of:

- The current international trends on the oversight arrangement in post Enron era and the impact of the same in the region;
- Assist regional professional bodies in dissemination of proper perspectives to the governments and regulators about circumstances, including state of economic development and role of corporate sector in the region and the actions required if any on the subject of oversight arrangement for accounting and auditing profession; and
- Preparation of an outline for future course of action.

During the Dacca session the Committee also had an opportunity to discuss the matter with the then Finance Minister of Bangladesh and it was mutually agreed that SAFA would issue its outline strategy in the form of a letter to the ICAB so that ICAB be assisted in presenting their viewpoint to the legislators and regulators. This letter has already been issued.

Historical Perspective of the Development of Accounting and Auditing Profession in the Region

Accounting and auditing profession in South Asia has been in league with practices followed in the United Kingdom as all the countries in the region in the past followed the practices developed in UK.

Furthermore almost all the corporate statutes were drawn from Anglo-Saxon models. In the early years of independence audit was mainly conducted by professionals educated and trained in UK.

In the post-colonial period [circa 1947] professional accounting bodies were formed these countries, specially in India, Pakistan and Sri Lanka.

All these bodies were constituted through special acts of Parliament such as Chartered Accountants' Act of India, Cost and Works Accountants Act 1949 and Chartered Accountants' Ordinance of Pakistan, 1961.

It is noteworthy that whilst the UK model was the archetype for drafting the aforesaid regulations, the UK accounting body is itself effectively not a creation of an act of parliament. It has evolved over a period of time and the professional body [ICAEW] represents a organization ‘Chartered’ by the Crown.

While legislating for the accounting profession local circumstances in the region were accurately taken into account. Experiences in UK were also taken into consideration. The legislators in this region in their wisdom at that time considered it appropriate that there should be a concept of ‘Public-Private Partnership’ in the matter of regulation of accounting profession. This in effect meant ‘Monitored Self-Regulation’. This objective was achieved by substantial participation of government nominated members in the councils of the institutes. There is almost 20 to 25 percent government nomination of government in the councils of Chartered Accounting Institutes of Pakistan and India and the Cost and Works Accounting Institute of India. This is a unique model in the sense that in other regions of the world including USA, UK, Europe, Japan, Singapore etc the growth of the profession undertook a different course, hereby its development preceded its recognition as the regulator of the accounting profession. In contrast, in our region both the acts were simultaneous. As a result the concept of monitored self regulation always remained a primary ingredient of our legislation on the subject¹.

This historical perspective is relevant to the discussion that follows since the issue of oversight and regulation of accounting profession primarily emanates from the subject of ‘public interest’ and level of self-regulations.

Prevalent Practices in the Region

At present, there exists no concept of public vigilance of the accounting profession in countries of the region. Proposed legislation in Bangladesh will be the first of its kind.

The Sri Lanka model is different from India and Pakistan in the sense that there is no independent government nomination in the council. 50% of the members are nominated by the government and this may include the Auditor General, provided he is a member of the Institute. However, there exist other bodies which are entrusted with the work of accounting standard setting etc.

Bangladesh follows the Indian and Pakistani models, the main difference being that there is no government nominee in the Council of ICAB. This model is closer to UK structure.

¹ Models adopted by Sri Lanka and Bangladesh are slightly different. The discussion is, therefore, primarily focused on India and Pakistan perspectives.

Furthermore in all the countries of the region there exists a very strong regulatory mechanism for corporate regulation by way of government ministries such as. Company Affairs Division and/or Securities and Exchange Commission etc.

Accounting and auditing profession effectively functions in line with the legislative framework laid down by these bodies. For example, accounting standards attain their statutory status once adopted or implemented by such governmental regulators. In India even cost accounting records are promulgated through government rules after considerable public debate. In effect, in such matters, the role of the accounting bodies is recommendatory in nature. There have been certain regulations relating to auditing profession in the region through corporate laws and/or the code of corporate governance on matters such as restricted services for auditors of the listed companies and appointment of auditors etc.

Models for the Regulation of the Auditing Profession

Auditing profession, the world over, has evolved over time and not through any common preordained system. Each region of the world had its own perspectives which revolved around their governance structure and the state of economic development, corporate law structure and education and training procedures. Over the time following models have emerged in respect of regulation of auditing profession:

1. **US Model** – In this case AICPA² is an independent body, not an institution formed through legislation. AICPA is even not directly involved with the training of accountants.
2. **United Kingdom Model** – In this case the profession is as independent so far its affairs are concerned. However, there is another body by the name of Financial Regulatory Authority (chaired and manned by the Government) for performing certain regulatory functions of the auditing and accounting profession. It is important to note that there is no government representation in the Council of ICAEW.
3. **European Model** – In the European model the professional bodies are independent, and are by and large an association of private entities. Government undertakes the function of regulation of accounting and auditing function directly through government directives and actions. Training and education are generally undertaken by universities.
4. **Indian and Pakistani Model** – Under this model professional bodies are creation of Act of Parliament and there is almost 20 to 25 percent direct representation of the government in councils of these bodies. The accounting bodies are directly

² American Institute of Certified Public Accountants.

engaged in education and training of professionals. This is termed as monitored self-regulation.

Almost all other models prevalent around the world revolve around one of the four primary structures identified above. In the post-Enron period serious deficiencies were identified in the US model which resulted in the promulgation of the Sarbanes Oxley Act (SOX) and resultantly the creation of Public Companies Accounting Oversight Board (PCAOB). The countries operating under other models have reviewed these developments, and processes are underway to identify the benefits of change so that appropriate amendments in the regulatory structures can be made. The 8th Directive of the EU is a step in that direction. There is, however, a predominant view that the US model is not an ideal example to follow. An analysis of all these models reveals that there are strengths in our model of public-private partnership vis-à-vis monitored self-regulation that can be successfully emulated in other parts of the world. Thus, any action for a major change needs to be taken after very detailed deliberation and examination of the experiences arising from other developments.

Public Interest and Socio-Economic State of the Region

The post-Enron debate on the subject of regulation of accounting and auditing profession commenced as a matter of ‘public interest’. In summary, it was felt that there should have been more consideration for public interest in the regulation of accounting and auditing profession. In the United Kingdom Financial Regulatory Authority existed much prior to Enron.

In the post-Enron period, there was a debate on the ‘trust’ and ‘confidence’ reposed in public financial reporting and consequently, the issue that came under discussion was whether or not the bodies regulating the accounting profession were capable of handling the same in larger public interest. This resulted in legislation of Sarbanes-Oxley Act (SOX) in USA and subsequently Public Company Accounting Oversight Board (PCOAB), also in USA. It is important to note that there was no major change in UK and Europe even after a major change was introduced in USA. The European Commission’s 8th Directive on this matter even considered the US model as an issue of ‘legislation by accident’.

In short, the matter to be examined is that there is no doubt in accepting the fact that public interest is the foremost consideration whilst regulating the profession. In that process experiments in certain jurisdictions should not be taken as only solution if there exists reasonable process of evolution within the existing framework.

The other important aspect with special reference to the situation in the region is that countries in this region are at a completely different stage of economic development and the existence of a corporate sector and its governance. Unlike developed countries, almost 65 to 85 percent of our Gross Domestic Product (GDP) is generated

by businesses which are not publically accountable entities³ on public companies. Furthermore there is still a very substantial contribution of state owned entities in GDP⁴. This state of economic development raises the issue of priorities for economic managers. The foremost priority in this region is ‘documentation’ and ‘corporatisation’. This process, with larger public participation, would result in reduction of cost of capital that would accelerate the rate of economic growth. However, one of the primary issues in economic development is lack of inappropriate governance in the public sector. In this situation, the matter of further regulatory mechanism in the accounting and auditing profession [that is reasonably growing and consolidating on an international level] should only be undertaken through a process of evolution rather than by following the accidental experiences in other regions.

In short ‘public interest’, ‘trust’ and ‘confidence’ in financial reporting are equally relevant to regional bodies. Increase of publically accountable entity’s contribution in the GDP would require concerted efforts for proper regulation of accounting profession in all its related fields. However, while undertaking any legislation or similar action in this area there has to a detailed analysis of historical perspective, legislative mechanism in existence, and the priorities for economic development.

Quality of Governance- Capacity of the Regulators

In the developing world one of the primary concerns about growth is the quality of governance and the capacity of the regulators. This raises the question whether or not any model being applied in developed countries, especially US, should necessarily form the basis of regulatory framework in our society after taking into account our inherent handicap.

In this context it would not be out of place to mention the ongoing debate in USA as to whether or not PCOAB has developed reasonable capacity to undertake the functions for which it has been created. Certain international studies on the subject revealed that there is a general perception [which seems to be a reality] that accounting and auditing profession, being a technical subject, requires highly qualified and sufficiently trained professionals who are difficult to induct and retain in the government sector regulatory bodies. This leads to serious capacity constraints for such bodies. On account of these handicaps such regulatory bodies are again outsourcing a substantial part of their function to the accounting firms for whose reformation or development such bodies were actually created.

We, in the region, are going through a process of reform in state run bodies and institutions. There has been a general feeling that there is a need for larger ‘public-private partnership’ in all sectors and solely government regulated bodies do not

³ This does not include government owned entities.

⁴ Their contribution is decreasing through process of privatization underway in almost all the countries of the region.

represent a correct model. Those bodies where discretion is wholly placed on state intervention do not yield encouraging results. The primary reason for the same is not entirely the issue of corruption or in competence. It is more of a matter of capacity building and human resource constraints.

Any discussion on oversight and regulatory mechanism has to account for the experiences, even in developed countries, and level and capacity of governance in societies of our region, and gradual degradation where there is excessive discretion.

Oversight or Regulation- Functions Perceived to be Undertaken

The terms ‘Oversight’ and ‘Regulation’ have been intermingled in the haste for regulation which was undertaken in US in the post-Enron era. The concept of ‘oversight’ connotes the perception of being recommendatory and advisory in nature. As against that regulations are more or less mandatory in nature. The functions usually undertaken by accounting oversight bodies will assist in understanding the issue in proper context. These functions have been identified as under:

- Establishment of auditing standards
- Establishment of ethics and independence standards
- Establishment of quality control standards
- Licensing of auditors and public accountants
- Investigation of audit failures
- Registration of public accounting firms that audit public listed companies
- Inspection of public accounting firms
- Supervising or monitoring the conduct of peer reviews or inspections
- Determining disciplinary actions
- Determining remedial and corrective actions
- Referrals of violation or possible violations to a body responsible for disciplinary, remedial and corrective actions
- Information sharing and coordination with foreign oversight bodies

An analysis of all these functions reveals that these can be divided into three broad categories which are:

- Standard setting
- Regulating the operation of the profession
- Disciplinary actions against delinquents

A further analysis reveals that all these aspects require highly skilled human resource and continuous up gradation of capability. This would require direct interaction between the proposed regulators, if any, and the professional bodies. There seems to be no other alternative. However, where such functions are distributed between two entities serious friction is bound to emerge. The relationship between ICAEW and Financial Regulatory Authority of UK is a case in study.

Over a period of time the process of standard setting is becoming globalised. In the near future there would be minimal probability where a country would wish to pursue standards that are contrary to international best practices. International Accounting Standard Committee (IASC) and International Accounting & Auditing Standards Board (IAASB) of IFAC would ultimately be the standard setters for the forthcoming accounting and auditing standards. In this situation, it is totally undesirable to create or conceive any governmental body of any particular country for that purpose. With reference to domestic standard setting as laid in the aforesaid paragraphs there still exists a reasonable process of public oversight for the reason that all standard setting procedures require statutory support for implementation. Accordingly it is not a viable idea to localize the affairs where there exists a strong reason for international standardization⁵.

The second aspect is licensing and regulation of auditing profession. There had been a strong demand for certain manner of licensing of firms allowed to conduct audit of the public interest companies and entities. The first step towards that approach was the concept of rotation of auditors. In the post-Enron era a debate started on compulsory rotation of auditors. IFAC conducted a detailed analysis of the same and came to the conclusion that this paramount right of the shareholder should not be tampered with. Over time, there is a broad consensus that compulsory rotation of auditors is not the solution for the perceived independence of auditors. It is now generally felt that the process of 'audit'⁶ has to be independent for which necessary safeguards have to be provided in the regulations such as QCR, restriction on services to be allowed to be conducted by auditors of public companies etc. Almost all the professional bodies of the region have introduced regulations on the same lines.

⁵ At present there is a very strong program of convergence of US FASB and IASC and in the auditing side IAASB is working for international standards for ethics, auditing standards, and quality control and peer review procedures.

⁶ There has to be a distinction between the concept of independence of auditor and approach of audit.

Furthermore, under the present state of affairs in general, in our societies, it would not be an ideal situation if informed shareholders were replaced by state appointed entity entitled for licensing of the audit firm.

The last aspect of disciplinary proceedings against the delinquents is an important issue. The concept of self-regulation is being challenged severely on this count. It is repeatedly stated and instances are quoted for the perception that appropriate independence does not exist if disciplinary proceeding are wholly left to the professional bodies. If we analyse the issue in depth it is revealed that the main objection against self regulation is arising in relation to actions against delinquents. Thus, there exists a need to either have an oversight arrangement for this purpose or the present system needs to be strengthened to achieve the desired goals. With respect to the options as laid down above, it is important to note that for the purpose of undertaking disciplinary action against a delinquent auditor there is a need for technical knowledge or expertise of the same or of higher level in the same field. A surgeon's negligence in an 'operation' can only be ascertained by another senior surgeon. It can not be done by an engineer. Thus the primary consideration in the matter of disciplinary proceeding is the involvement of professionals in disciplinary actions. Such a body of persons can only be made available on continue basis by a professional body only. Nevertheless a final analysis would require independent persons to make a final decision. This leads to higher level of independence for disciplinary process within the purview of a professional body.

In the recent past, there has been an amendment in the Indian Chartered Accountants Act, 1949 where there have been amendments in the process of disciplinary proceedings. Similar amendment have also been made in the Cost and Works Accountants Act as one section of the members constitute public accountants. This process is almost in line with the principle laid down in the aforesaid paragraphs.

This discussion reveals that there are specific functions which are deemed to be carried out by an oversight body. Under the given set of circumstances in our region there has been a process in place for reform and reasonable amendments and developments are being made to achieve those objectives. In this situation there is a need for development of professional bodies with greater involvement and interaction of regulators, through nominations in the councils, rather than going through any process of establishment of any other regulatory or oversight arrangement.

Recent Initiatives in the Region

Pertinent improvements which have been undertaken with regard to initiatives for improvement of regulation of auditing profession are implementation of Quality Control Procedures (QCR) and independence of disciplinary proceedings. For that matter amendments have been made in the Chartered Accountants Act, 1949 of India. In Pakistan almost similar amendments have been proposed in the Chartered

Accountants Ordinance, 1961. QCR program has been implemented mandatorily in Pakistan through Code of Corporate Governance.

Another important aspect is the restriction of services to be provided by the auditors of the listed companies. In almost all the jurisdictions permitted services are only those which are in accordance with the IFAC Code of Ethics.

Strategy and Suggestions

These discussions reveal that there is no immediate need to undertake any action with regard to regulatory mechanism of the auditing profession. The concept of an independent oversight or regulatory mechanism requires further deliberation, and any regulation or enactment such as that being proposed to be undertaken in Bangladesh is not warranted at present. This approach will not meet the desired results.

The ROSC report has identified the issue in a particular frame of affairs at the time when sentiments and experiences arising from US model were practically untested. Practical and legislative structures as prevalent in this region were therefore not totally accounted for while suggesting recommendations in the ROSC reports. There is a strong urge in the ROSC report for developing the capacity of the present corporate regulators. The professional bodies and the governments should, at the first stage, work for strengthening their capacity rather than creating another body that is expected to have serious resource constraints. Accordingly it is suggested that:

- There should be an endeavor to organize on a regular basis the study of the oversight functions of the auditing profession in line with the initiatives undertaken by IFAC. For that purpose, it is suggested that at the initial stage there should be regular Committee of SAFA for that purpose.
- The interaction with governments and World Bank on this issue should be strengthened and the representatives of the World Bank be apprised of the developments in the region through their participation in various discourses of SAFA.
- Developments being undertaken in various other areas be carefully examined specially those being undertaken in US and experience of interface of UK FRC with ICAEW.
- Steps to be undertaken to bring harmony in the regulatory framework of the profession in the region especially in the matter of composition of council, disciplinary proceedings, quality control mechanism and licensing of firms to conduct the audit of public companies and public interest entities.

-
- SAFA through its interface in Developing Nations Committee of IFAC [where its nominees are reasonably represented and where there is strong presence of World Bank and other bodies] for a reexamination of ROSC reports in the light of the issues laid down in this report.

Conclusion

The Committee concludes that recent initiatives undertaken in various countries of the region specially India, are steps in the right direction for tackling the matter of safeguarding 'public interest' and building trust and confidence in public financial reporting in relation to regulation of auditing profession. The statutory framework existing in the countries of this region for regulating the auditing profession represents a monitored self-regulation system that is deemed to be appropriate based on public private partnership. In these circumstances, the Committee considers that there is no basis to legislate or create any independent public interest oversight authority for the regulation of the auditing profession in any country of the region. Nevertheless, the Committee considers it appropriate to suggest all that countries bring their systems in line with the basic framework as briefly identified in this report. It is recommended that this matter requires continuous study and review in the years to follow.



Regulation of the Accountancy Profession



International Federation
of Accountants

*Copyright © December 2007 by the International Federation of Accountants (IFAC).
All rights reserved. Used with permission of IFAC. Contact permissions@ifac.org for
permission to reproduce, store or transmit this document.*

IFAC'S POSITION ON PROFESSIONAL REGULATION

Introduction

1. High quality performance by professional accountants benefits the economy and society by contributing to the efficient allocation and management of resources in both the private and public sectors, and to the operation of financial and capital markets, and through these to the production of goods and services. In doing this accountants help to improve standards of living and overall wealth.
2. In recent years, how the accountancy profession should be regulated has been the subject of much debate, and there has been much consequential change, as professional accountants, their clients, professional accountancy bodies and governments seek to ensure that the profession continues to deliver high quality services and contributes to economic growth and development.
3. Recognizing the importance of this issue, the International Federation of Accountants (IFAC) has formalized in this document its view that professional accountancy bodies, acting in the public interest, must play an active role in the regulation of the profession and that professional accountancy bodies and governments need to work together to ensure that regulation is effective and efficient.

Professional Organizations and the Public Interest

4. Members of all professions and professional bodies have an important responsibility to the community in which they live: to the public interest, not just to their current clients or employers or to themselves. This is one of the characteristics of a profession.
5. While individual members of a profession have an obligation to serve the public interest, professional organizations have a more specific responsibility and role in this regard. One of the fundamental objectives of any professional organization is to provide assurance as to the quality of services provided by its members. To achieve this, professional bodies must be dedicated to upholding and promoting high quality professional practices, including through the regulation of their members. In this way, they contribute to the public interest, which is an essential characteristic of professional organizations. The professional body needs to regulate the activities and conduct of its members to ensure that its responsibility to the community is fulfilled, even if there is significant external regulation of the profession by a government agency.

The Accountancy Profession

6. Accountancy is a profession, as described above, and its members and its professional institutes have the obligations outlined. Members of the accountancy profession contribute to their communities in a wide variety of different roles, and within a range of different organizations.
7. Professional accountants work in virtually all sectors of the economy. They work in public practice, in large, medium and small firms, and as individual practitioners. They also work within commercial, industrial and financial enterprises, non-profit organizations and public sector entities, including academic institutions. Professional accountants, therefore, contribute across all sectors of the economy.
8. The roles that professional accountants play, in whichever sector of the economy they work, are very diverse. They work in the areas of accounting and financial reporting, management, taxation, information systems, corporate finance, and business intelligence. They also work as internal or independent auditors or as consultants across a range of specialist areas. Many also serve as academics in a wide range of educational institutions.
9. Professional accountants therefore contribute to the growth of individual companies, support and sustain non-profit organizations, and assist governments in achieving their economic and social objectives. They also contribute to financial market performance, through the reporting of, and providing assurance on, financial information on which investors and other stakeholders rely. In these ways and others, professional accountants contribute to the growth of economies and ultimately to the well being of society.

The Need for Regulation

10. Every profession is defined by the knowledge, skills, attitude and ethics of those in the profession. Regulation of a profession is a specific response to the need for certain standards to be met by the members of that profession. The need for and nature of such regulation is dependent on the specific profession and the market conditions in which it operates.
11. Like other professions, the sustainability of the accountancy profession depends upon the quality of the services provided by its members and on the profession's capacity to respond effectively and efficiently to the demands of the economy and society. Regulation seeks to ensure the right quality and, where appropriate, consistency in the quality of accountancy services.

-
12. There are a number of reasons why regulation might be necessary to ensure that appropriate quality is provided in the market for accounting services. These include enforcement of ethical rules and technical standards and the need to represent non-contracting users of accounting services, such as investors and creditors. In recent years, for example, ethical failures on the part of some members of the profession, and the resulting lack of confidence in financial reporting resulted in changes in the regulation of the profession in many parts of the world.
 13. While the specific triggers for regulatory intervention will differ over time, there are two general cases that provide useful illustrations of why regulation may be an effective means of ensuring quality and addressing issues in the operation of the market for accounting services. The first general case arises from the situation where there is a knowledge imbalance between the client who is acquiring accounting services and the provider of those services, who has professional expertise. The second general case is where there are significant benefits or costs from the provision of accounting services that accrue to third parties, not to those acquiring and producing the services.
 14. Regulation can address the knowledge imbalance between the provider and purchaser of professional services by providing assurance to the purchaser that the provider has the necessary qualifications and will meet the appropriate professional standards in his or her work. In this way, the purchaser is given assurance that they are receiving services of the right quality.
 15. The second generic issue that regulation can address is where parties outside the contracting parties (the purchaser and provider of services) either receive benefits or incur costs as a result of the transaction. Regulation can ensure that those benefits and costs to third parties are taken into account in determining what service is to be produced, and at what quality. Because financial statements have a much wider use than by the company acquiring an audit, for example, regulation of financial reporting and audit ensures that investors or potential investors (the third parties) receive the information they require. Regulation acts to ensure that the benefits to these third parties are “built in,” when a company contracts for an audit.
 16. The market for professional accounting services has the potential to be inefficient and regulation is used to mitigate the potential impact of this inefficiency on the economy and society. In designing regulation, however, care needs to be taken that the nature and characteristics of the potential issues for the operation of the market are well understood; otherwise, the regulation may not achieve its purpose.

-
17. Regulation seeks to ensure that accounting services are of the right quality. Similarly, regulations affecting the accountancy profession, like all regulations, need to be of the right quality. To meet the public interest, they must be proportionate, transparent, non-discriminatory, targeted, implemented consistently and fairly, and subject to regular review. In addition, effective regulation must not be anti-competitive. The benefits of regulation to the economy and society should outweigh the costs of that regulation and this is more likely if regulation meets these criteria.

What Areas Does Regulation Typically Cover?

18. Regulation of the accountancy profession usually covers the following: entry and licensing requirements, including education requirements; monitoring of the behavior and performance of professional accountants; the standards, including ethical standards, that professional accountants must meet; and disciplinary systems and procedures for those who fail to meet the requirements.
19. It is important to have high quality standards as these provide a foundation for members of the profession, users of accounting services and regulators to assess compliance with best practices by members of the profession. Compliance with regulation is facilitated by high quality standards. The rationale for regulation and for standard setting is the fulfillment of public interest objectives.
20. The aspects of a profession that are regulated should be those necessary to address the generic issues described above. The effect of well-designed regulation will be to provide assurance that accounting services are of the nature and quality that is needed both by the acquirers of those services and by the wider economy.

The Value of Ethical Behavior

21. While regulation is important, it is not on its own enough to achieve the objective of assuring quality and consistency of quality in the provision of professional services. IFAC recognizes that values also are critical in driving behavior. No regulation can be truly effective unless it is accompanied by ethical behavior.
22. It is the ethical behavior of the professional accountant that is the ultimate guarantee of good service and quality. Education in values, especially through example and the appropriate use of experience and professional judgment, based on a solid educational foundation, and reinforced through continuing professional education, will be essential to the future of the accountancy profession.

-
23. Regulatory systems should be designed to promote and to achieve these behaviors. High quality service from the profession is ultimately a function of professional standards, including ethics, personal competencies and values, and regulatory systems, all of which must be consistent with and supportive of one another.

How Regulation Can Be Implemented

24. The regulation of professional accountants can be implemented in several ways. The two primary ways are self-regulation and external regulation. Under self-regulation, the professional body is recognized by government and government delegates to the professional body responsibility for regulating the profession. Under external regulation, the profession is regulated by the government either through a government agency or through an independent agency which has been created and delegated regulatory powers by the government. A combination of self-regulation and external regulation is often used to regulate the profession. Self-regulation and external regulation reinforce each other; they should be acting in way that is complementary to each other, not competing. Both methods, and their combination, should be evaluated periodically for effectiveness.
25. There are a number of ways that self regulation and external regulation may be combined to create an efficient and effective regulatory mix. One combination is self-regulation with oversight carried out by an independent agency, where that oversight complements and adds strength to self regulation. Another combination could have the professional body being responsible for some aspects of regulation and a government or independent agency for other aspects. For example, a professional body may have responsibility for aspects of regulation where it has significant expertise. Setting education requirements for professional accountants, for instance, is an area where the accountancy profession may have significant expertise and so may be better placed to regulate it.
26. The mix of self-regulation and external regulation used in a particular country can depend on a number of factors including:
- The historical experience in the jurisdiction, for example, financial reporting failures have often led to more external regulation;
 - The self-regulatory performance of the professional body;
 - The regulatory performance of government;
 -

-
- The general political orientation to regulation as an instrument of economic management;
 - The development path of the economy; and
 - The nature and characteristics of the market failures to be addressed by regulation.
27. In practice, a professional accountancy body very rarely regulates without some form of government mandate or oversight. Similarly, the government rarely regulates without any form of interaction with, or explicit or implicit delegation of authority to, the professional body. Trends in the balance between self regulation and external regulation may also differ. In recent years many countries have seen an increased role for external regulation, while in other countries, especially those in transition, the trend has been to strengthen the self regulatory role of the profession.
28. Commonly, professional accountancy bodies, in many cases IFAC member bodies, act under a delegation from their respective governments. The government has given legal recognition to the professional body and has given it a set of roles and responsibilities and some form of reporting requirement. These responsibilities can include setting admission criteria, setting education requirements, including continuing education requirements, establishing disciplinary procedures, and setting professional standards. Reporting requirements vary, but can take the form of annual reports by the professional body to the government. Even in environments where the profession is highly regulated by the government, there is still an obligation on the professional body to conduct some significant elements of self-regulation.

The Role of Professional Accountancy Bodies

29. Professional accountancy bodies must play a role in the regulation of the profession to ensure the quality of the services provided by their membership. Undertaking this role is in the interests of both the public, who need quality services, and of the professional accountancy body, whose own reputation will reflect the quality of services provided by its membership.
30. In addition, professional accountancy bodies are close to the markets in which their members operate and, thus, have a good sense of how regulations might affect behavior. They can also more easily access this information and draw upon the skills and experience of their members to regulate the profession. In particular, they have an ability to respond and act quickly in light of changing circumstances.

-
31. Professional accountancy bodies, acting within the mandate granted to them by government and alongside external regulation and oversight, can perform their regulatory responsibilities in a manner which increases the overall effectiveness of the regulatory system.
 32. Professional accountancy bodies also have a role to play in the development of regulation affecting the profession. They have a responsibility to communicate and work with governments in the public interest; to use their knowledge of the profession and the markets in which it operates to assist government and external regulatory agencies to design and implement high quality professional regulation that is effective in ensuring quality.

The Role of Government

33. The role of government in the regulation of the accountancy profession is to ensure that regulation is achieving its public interest objective to ensure – at the lowest possible cost – quality, and consistency of quality, in the supply of accountancy services. To do this effectively, governments need to:
 - Understand the nature and characteristics of the issues that regulation is seeking to address;
 - Have in place a system for monitoring the performance of the body charged with regulating the accountancy profession;
 - Be focused on outcomes, in this case the overall quality and consistency of accounting services; and
 - Have an ability to amend legislation and regulation quickly where circumstances require.

Characteristics of good regulation

34. It is also necessary that governments and professional accountancy bodies regulate in conformance with the criteria noted above, so that regulation is proportionate, transparent, non-discriminatory, targeted, implemented consistently and fairly, and subject to regular review. Regulation that meets these criteria is more likely to achieve the required outcomes and to be acceptable and credible to the public at large.
35. Regulation of the profession needs to be transparent. Transparency is particularly important as it enables the public to know and understand how the profession is being regulated and what the regulator is doing. This information adds to the credibility of regulation and makes it more effective

by giving the public the ability to judge the value of regulation and its impact on the market for professional services.

Conclusion

36. Professional accountancy bodies and governments share a common objective of ensuring that professional accountants serve the public interest and meet high standards in the quality of the services they provide.
37. These concerns for the quality, the behavior and the standards of professional accountants, and the awareness of the public interest imperative for the accountancy profession, means that professional accountancy organizations and governmental regulators have a very substantial commonality of interests and objectives.
38. How the profession is regulated is an important means to achieve these aims. If regulation is to be effective, there needs to be ongoing dialogue and an alignment of actions between governments and professional accountancy bodies. This dialogue should address developments in the profession and developments in the economy and society that may affect the profession and how it performs its role. Dialogue is essential if regulation and regulatory systems are to remain current, efficient and effective.
39. IFAC's position on professional regulation is one in which professional accountancy bodies continue to play an important role in regulating the profession, alongside the regulatory functions of the government or its agencies. The specific regulatory role of professional accountancy bodies should depend on the situation in the particular country, but in all cases the professional body has a responsibility to ensure the profession serves the public interest.
40. Professional accountancy bodies must have an ongoing dialogue with government to find the right balance between self-regulation with public oversight and external regulation. This dialogue is crucial to ensuring that overall regulation of the profession is of high quality and that the benefits of regulation exceed the costs, and in ensuring that regulatory systems change over time as market demands for accountancy services change.
41. Finally, while regulation helps to ensure the quality of services that professional accountants provide, ultimately it is the ability of the profession to put the public interest first that will earn the profession the respect of communities and regulators around the world.