



Panel I Discussion — Audit Quality: How can auditors, directors, shareholders, and regulators collaborate to strengthen audit quality?

Moderator John Humphrys opened the panel discussion on audit quality with a topical—if controversial question—were not the auditors taken by surprise by developments coming out of the current “sub-prime” credit crisis. And, if the answer is yes, is that a comment on audit quality in general?

Tim Flynn, Chairman, KPMG International, who agreed it was a fair question, did not necessarily agree that the crisis should have been spotted and prevented by the accounting professionals of the involved institutions. He said there were no clear, forward looking indicators of the problems that have been developing over the past year or more. He also agreed that the issue raises the matter of the accountant’s role in reviewing business model viability versus accounting for the factors that are presented.

Peter Montagnon, Director of Investment Affairs, Association of British Insurers, added that while the auditors may not have been at all times performing perfectly, they should not be put in the role of scapegoats either. Little was known, he said, about off-balance sheet loans, but it is for certain that all parties involved in the crisis—banking executives, regulators, accountants, boards—must do everything possible to rebuild confidence by being able to ensure nothing like it will happen again.

“Clearly, there was an appetite for these types of products among consumers,” offered Mark Olson, Chairman, Public Company Accounting Oversight Board, “and it came upon us so quickly...there were so many issues involved that it will be difficult for the profession to get ahead of this problem, but that is what we need to do.” Helmut Perlet, Chief Financial Officers, Allianz SE, concurred with the complexity of issues involved, but noted that ultimately it is “a crisis of confidence.” Everyone involved may have thought the risk was being spread over a lot of broad shoulders, he suggested, but now everyone is paying the price for lack of transparency.

Discussion of the current credit crisis led to reminiscences associated with the series of business scandals and failures that produced Sarbanes-Oxley (SOX). Olson noted that whenever these types of events occur, the pendulum of reporting swings dramatically. With regard to SOX, he believes there has been a lot of constructive progress around internal controls and other benefits and now there’s better balance between the costs and benefits of implementing SOX reforms.

The panel agreed that there are always lessons to be learned from a crisis, and this one, like the ones involving derivatives, commercial real estate loans, and high tech business failures that came before, will undoubtedly result in important changes that further improve audit quality.



In addressing the issue of what constitutes quality in an audit, Flynn said that stakeholders must continue to talk and work together to find the right balance, to define what needs to be known in the financial statements, to determine materiality, and to understand what level of precision is achievable. When it comes to audit quality in developing countries, Flynn said, “We can’t wait for the regulators to raise the bar, we have to move forward with what we know we need to look for.”

The biggest problem with audit quality, Montagnon pointed out, is determining exactly what it means. The panel exchanged views on whether quality is mostly a matter of skills, experience, or the right emphasis on client service. They generally agreed that it is much easier to spot a bad audit than a good one. Some argued that the role between the auditors and management is a delicate balance between understanding important underlying principles and supporting deterrence of questionable practices and appreciating that businesses are answerable to shareholders who want results. All seem to agree that headway has been made and more rigor has been added to the process. The profession is headed toward accounting standards that can provide assurance that company executives are managing assets properly.

“Ultimately, the value of a high quality audit will be determined by investors—is it worthwhile?” said Montagnon. “As with most things in life, most people will agree that if you want quality, you have to pay for it. Audit firms must ensure that investors are getting value out of the process.”

Humphrys raised the issue of auditor liability and litigation. Some panelists felt that changes in the profession, notably some firms in Europe looking at outside ownership, and others considering different views of capitalization, will lead to a more effective discussion of liability in the future. Flynn acknowledged the complexity of the issue and how the outcomes can impact the sustainability and long-term health of the profession. The key question, he suggested, is how the judgment of auditors is evaluated by courts and regulators. “This issue needs a transparent, open debate, representing investors, regulators, and the firms, and not a quick fix—like a liability cap,” he said.

Olson and Steven Maijor, Managing Director, Netherlands Authority for the Financial Markets, turned the discussion to issues associated with emerging markets. They pointed out that with respect to developing markets, there is a vast difference between where issues of audit quality stood five years ago and today. “There are now oversight groups in many countries around the world whereas five years ago there was almost no government mandated oversight groups in these markets,” Olson said. “Convergence work being done in accounting is beginning to apply to audit, though we’re not as far along in audit yet. I believe the global flow of capital will drive consistency in the standards.”