

Building an Investment Climate of Trust

“It is, for me, as much a personal objective as a professional one. I believe that each one of us involved in the investment field has a personal responsibility to deliver trust. To each other. To employees. To investors. Investors must not only trust the financial information they receive, but trust the individuals that supply that information, including company management, external auditors, analysts, exchange managers and stockbrokers. It is the foundation of all relationships, both personal and professional, and the most necessary component to the effective operation of capital markets around the world.

Investors are increasingly realising that there is, literally, a world of opportunity awaiting them. With the world's equity market capitalization estimated at about \$35 US trillion dollars, and more growth on the horizon, investors are faced with increasing choices. How, when, why and if they choose to invest depends, in great part, on their confidence in capital markets in general. That confidence is not something any of us can afford to jeopardize.

We live in a global market for investment capital and that market has great potential to fuel economic growth and stability. All of us here today have a role to play in promoting and protecting the integrity and stability of the market so that that potential can indeed be seized by investors, business people and others. We know from experience, too, that the integrity and stability of mar-

Following are the extracts of the speech delivered by Mr. Graham Ward, President, International Federation of Accountants at the World Federation of Exchanges (WFE) in Mumbai on November 1, 2005.

kets are maximized when investors feel they are adequately protected against fraud and corruption and when they feel they can truly rely on financial information produced by companies. All of us have a role to play in boosting that confidence.

IFAC's mission is very similar to that of WFE's. The IFAC's mission is to serve the public interest, to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant. Like the WFE, our focus is also on integrity. In fact, IFAC's values of integrity, transparency and expertise are at the core of all IFAC activities.

More than 2.5 million professional accountants worldwide, represented by IFAC's 163 member bodies based in 119 countries, are expected to adhere to these core values. It is only by adhering to these values that the individual accountant can effectively contribute to building investor trust and confidence. Accountants must not only act honestly, but be honest; they must be willing to be transparent about all their activities, not

just selected work; and they must be dedicated to maintaining the professional competencies to carry out their work throughout their careers. Strong personal commitment is necessary for accountants to behave in this manner and ultimately to build an investment climate of trust.

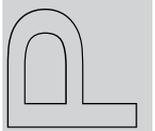
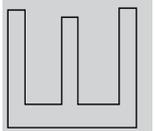
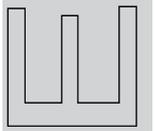
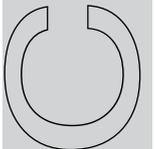
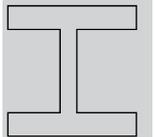
IFAC is also reaching out to the developing world. Because we are a global organization, and because it is predicted that 95% of the world's population growth will occur in developing nations, we have made strengthening the profession in those nations a key objective. We are the business experts. Establishing a sound and viable accountancy profession is a critical step in building a sound financial infrastructure and a reliable capital market system.

IFAC's goal is to have an established accountancy profession in every country around the globe. There is no doubt that this is a lofty goal, but as we look ahead and see that the growth of the world's population will largely be in developing economies, I am more and more certain that this goal is one which we cannot compromise or forsake. We are in the process of finalizing a developing nations tool kit that will assist these countries in establishing an accountancy body and, where an accountancy body exists, further develop and enhance



Graham Ward

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it. More than this, we will facilitate ongoing, committed support from developed accountancy bodies to provide practical, long-term help.

Just as the WFE works to support newer and smaller exchanges, IFAC also has a focus on small and medium practices (SMPs) and entities (SMEs). We well recognize that in many countries the world over, including here in India, SMEs play a very significant role in terms of contributing to economic growth. In the Asia Pacific Economic Cooperation, which represents some 20 countries and more than 47 per cent of world trade, SMEs make up about 99 per cent of all enterprises. They are also the backbone of the European economy, representing 99 per cent of all enterprises in the EU. IFAC's focus on SMEs is simple: to help them to deliver high quality work by both serving as a resource and providing relevant guidance. As SMEs struggle to compete in a global world, they, like larger entities, must be aware of a wide range of international rules and regulations. Often faced with resource constraints, this can be difficult to manage. IFAC is commissioning the development of an electronic information exchange for SMPs and SMEs, and a guide to international standards on auditing. designed specifically for the audits of SMEs. We view the development of this guide as essential to helping SMEs to meet their responsibilities to the public and to boosting investor confidence.

Let me now turn to some of the global initiatives IFAC has undertaken since January, to help the accountancy profession to meet its public interest responsibilities and to contribute to economic growth and stability, by focusing on four critical areas.

First, before all else, we must actively promote adherence to high ethical standards by all professional accountants, including those in private industry, public practice and government.

Secondly, we must be a vocal advocate for strong corporate governance, both within the profession and to management.

Thirdly, we must develop and encourage adherence to high professional standards so that accountants know what it takes to deliver quality.

Lastly, IFAC must demonstrate to the world that the profession is meeting its responsibilities to deliver quality and to protect the public interest. In other words, we must show that the work we do is, in fact, making a difference.

Let me return to the first point – promoting high ethical standards.

Ethical conduct lies at the core of all business. We do business with those we trust; we get business from those who trust us. It is at the root of generating confidence in both individuals and entities. Ethics, therefore, is a driver of business growth, which demands attention from boards and investors alike. We also need to remember that ethics is personal. It involves a commitment to values that affect how each of us makes our personal decisions and, in fact, how we live our lives each and every day.

IFAC's values of integrity, transparency and expertise are reflected in every facet of our work. To build credibility in financial systems and to contribute to sound economic systems, we must also promote these values to all professional accountants, both in practice and in business, as well as to all those in the financial reporting supply chain. And we

must do so in a way that is relevant and meaningful. IFAC's Ethics Committee, which develops the international Code of Ethics for Professional Accountants, does just this. The committee recently released a revised Code of Ethics, which establishes a conceptual framework for all professional accountants to ensure compliance with the five fundamental principles of professional ethics. These principles are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Under the framework, professional accountants will be required to identify threats to these fundamental principles and, if there are threats, apply safeguards to ensure that the principles are not compromised. The framework applies to all professional accountants, those in public practice as well as those in business and government. The Ethics Committee, recognizing that both governmental and business accountants play significant roles in safeguarding the public trust, plans to provide further guidance for these accountants in the near future.

The Ethics Committee is also focused on an issue that is perhaps most central to public trust and one that has received widespread attention by the media and regulators: auditor independence.

IFAC has also focused on promoting strong corporate governance. In an independently written report commissioned by IFAC, *Rebuilding Public Confidence in Financial Reporting*, developed two years ago under the leadership of John Crow, former governor of the Bank of Canada, it was emphasized that actions must be taken to strengthen corporate governance. For example, corporate management

must place greater emphasis on the effectiveness of financial management and controls, corporate ethics codes need to be in place and effectively monitored, and threats to auditor independence need to be given greater attention in corporate governance.

The findings of this report provided much impetus to IFAC's Professional Accountants in Business (PAIB) Committee, as well as to other international groups. The PAIB Committee is in the process of finalising a document on corporate codes of conduct, which, among other things, highlights the professional accountant in business's role in developing, monitoring and adhering to such a code.

This IFAC committee has also turned its attention to how best to improve the performance of organizations, and thus ensure wider prosperity for all. In 2004, our Professional Accountants in Business Committee, working with The Chartered Institute of Management Accountants (CIMA), issued a report on corporate governance best practices entitled, *Enterprise Governance – Getting the Balance Right*. The joint group conducted an in-depth analysis of corporate successes and failures in 27 case studies from 10 countries. Among the report's findings were that there are four key determinants of corporate success and failure: the culture and tone at the top, the chief executive, the board of directors and the internal control system.

The report also revealed that good governance on its own cannot make a company successful. Companies need to balance conformance with performance. To quote: "Unlike the conformance dimension, there are no dedicated oversight mechanisms, such

as audit committees, in the arena of strategy. ... There is a danger that in the laudable attempt to improve standards of control and ethics, insufficient attention is paid to the need for companies to create wealth and to ensure that they are pursuing the right strategies to achieve this."

The study examined the concept of 'enterprise governance.' Enterprise governance has two equal parts: probity and profitability. I would suggest that one without the other isn't worth having. Businesses that have the highest ideals but go bankrupt, through poor strategic choices, are as disastrous to shareholders, to other stakeholders and to public confidence as are businesses that fail because of ethical lapses.

At the same time, a profitable business that is managed and overseen with little regard for the public interest, the law, regulations, employees or shareholders should not be in business and, ultimately, will not be in business. Of course, this concept does not apply only to the private sector, to industry and to for-profit organisations. Instinctively, those who work for international organisations, national governments and agencies, and non-governmental organisations understand that they too need to have integrity in all that they do, while at the same time making wise strategic choices that ensure organisational success.

Let me turn now to standards and the need for a common set of recognised and accepted international standards.

The Task Force on Rebuilding Public Confidence in Financial Reporting also recommended that audit standards and regulation be strengthened and that the progress of convergence to in-

ternational standards be more urgent. IFAC has invested, and continues to invest, a significant amount of effort in these areas. We well recognize that in order for practitioners to deliver quality, they need high quality, internationally accepted standards. Thus, at IFAC, increased effort has been placed on enhancing our standard-setting processes, on improving the transparency of those processes and on devoting more resources to them.

The International Auditing and Assurance Standards Board, our Ethics Committee, our Education Committee, and our International Public Sector Accounting Standards Board have increased the public interest input into their standard-setting processes. The IAASB, Ethics Committee, and Education Committee all include public members and such members will be appointed to the IPSASB next month. In addition, all of these groups now have consultative advisory groups, comprising relevant stakeholders, who can provide meaningful input to the work programs of each group from a public interest perspective.

The international Public Interest Oversight Board (PIOB), formed in February this year and chaired by Professor Stavros Thomadakis (a former Chairman of the Hellenic Securities Commission), has eight members and two observers, all very senior people, appointed by international bodies of regulators and institutions. The PIOB oversees the work of IAASB and of IFAC's Ethics and Education Committees and endorses appointments to them. In September 2005, it approved the due process and working procedures that they should follow. Recently, the Education Committee released an exposure draft on the train-

ing of audit professionals, recognizing the special needs of this segment of the profession. It is also in the process of preparing a tool kit on ethics, featuring different approaches to ethics education. This should be completed by the end of the year.

IFAC is committed to all accountants carrying out high quality work. The developments in governance public interest oversight, auditing, ethics and education, will improve the quality of audited financial statements and, thereby, the quality of information received by the capital markets and capital allocation decisions. In this context **I would like to recognize the high quality work carried out by the Institute of Chartered Accountants of India, led by its President, Shri Kamlesh S Vikamsey, in promoting high quality standards of auditing in this country.**

Through its International Public Sector Accounting Standards Board (IPSASB), IFAC develops International Public Sector Accounting Standards, designed to improve public sector financial management and accountability. We view this as an increasingly important area of IFAC activity. Governments, both how they operate and perceptions about how they operate, have a strong influence on investor decisions. Governments, perhaps more than any other entity, must have a strong public interest focus. After all, they are the ones to whom most of us entrust our money in the form of taxes. They are the ones that control state and national budgets, or in other words, our money. And they are the ones that make fiscal decisions that affect the well-being of the world's citizens.

IFAC's International Public Sector Accounting Stan-

dards, which are based on International Financial Reporting Standards (IFRSs), enhance governmental accountability at all levels. Support for the standards from the OECD, NATO, and the World Bank has further enhanced the value of these standards and the importance of achieving convergence in this important area. This is, in fact, an area in which IFAC is moving steadfastly ahead. In October, the IPSASB issued a new ED proposing changes to 11-accrual basis IPSASs to reflect developments in the equivalent IFRSs.

Convergence with national standards is one of IFAC's most important objectives and one which, I believe, is at the core of building an investment climate of trust.

Here's why. Globalisation demands high-quality standards that can be applied from Madrid to Mumbai, from New York to Nairobi. This puts everyone on a level playing field.

Second, global standards will result in increased transparency and accountability. Investors will be better able to compare company financial statements across borders. I also believe that developing countries that adopt international standards will see increased investment in their economies, by institutional and retail investors who are familiar with, and confident in, the standards, regardless of geography.

There's another consideration as well. Having a multiplicity of accounting, auditing and other standards around the world is against the public interest. It creates confusion, encourages error and facilitates fraud. The cure for those ills is to have a single set of international standards, of the highest quality, set in the public interest by an international expert body, which transparently consults with, and recog-

nizes the legitimate interests of, the international community. Such standards will also reduce the cost of capital, increase access to capital and, thereby, improve economic growth and corporate profitability.

In consultation with IFAC boards and committees, and other relevant interested parties, IFAC staff are further developing the concept of "international convergence." The objective is to develop guidance to accompany IFAC's Statements of Membership Obligations (SMOs), which form the basis of the IFAC Member Body Compliance Programme.

This programme supports the development of high quality auditing, accounting, ethical, educational and related quality assurance and disciplinary standards in IFAC member bodies throughout the world. The program is intended to guide accounting institutes in the full spectrum of their professional responsibilities, to demonstrate a shared commitment to our profession's values of integrity, transparency and expertise.

Phase 1 of the Compliance Program, a fact-based questionnaire to assess the regulatory and standard-setting frameworks of IFAC member bodies, is now complete. More than 60 responses have been posted on the IFAC website and the goal is to have all responses posted as soon as reviews are completed. The responses to Part 2, an SMO Self-Assessment questionnaire, will be posted to the IFAC website next year. The responses from these questionnaires are important for several reasons: they provide a global, publicly available snapshot of the accountancy profession from both a regulatory and standards perspective and they can be used to help

IFAC gauge where it needs to focus its efforts to support the development of the profession and to work to achieve convergence. Perhaps most importantly, however, the responses to the questionnaires demonstrate the international accountancy profession's willingness to be accountable for its actions to meet high standards, to deliver quality and to protect the public interest. In other words, this programme demonstrates that the profession is fulfilling its promise to the public. All the documents to which I have referred are publicly available on IFAC's website www.ifac.org.

As we look to the future, the international accountancy profession, regulators, standard setters, stock exchanges and all those involved in capital markets will continue to face new challenges to build an investment climate of trust.

In anticipation of these challenges, and in recognition that we must never waiver in our commitment to build public trust, IFAC's Board has recently agreed to lead a new study on enhancing the quality of the financial reporting supply chain. The project will identify investor expectations and needs and include practical suggestions for enhancements that the global accountancy profession can provide by direct action and those where it will need to engage with others to create change. Among the issues to be considered in the new study are corporate management and governance, regulatory developments, auditor independence and rotation, and the expectations around the board's and the auditor's responsibility for the detection of fraud.

Finally, as we all look ahead, we must consider the

needs – social, economic, and health – of a growing population. As the 20th century ended, world population reached 6 billion, increasing by 82 million people every year in less developed countries compared to 1.5 million in more developed countries. The challenge for all of us here is how to develop our professions and our roles so that we facilitate the development of prosperous societies that can both support the increasing global population and fight poverty.

Meeting this challenge does, I believe, begin with building trust. Without strong ethics, we cannot bring about social stability. And without trust, we cannot build sound economies. All of us can, and should, work together to address these issues and to improve the quality of life of the world's citizens." □