

Audits: More necessary than ever, but only as good as the professionals who stand behind them

Canada must aim for public accounting excellence

Brian Hunt, Financial Post

At a time when a number of the world's largest and best-known financial organizations have run into difficulties, some have asked why their auditors couldn't have sounded alarms in advance. In fact, a few critics, using the benefit of hindsight, have questioned the value of audits altogether.

Ontario CAs have no doubt that public accounting in general and audits in particular have always been worthwhile and important to our economy. Not only must we continue to rely on the audit process, we must focus on improving it and ensuring the right people are doing the job -- the last part of which will be particularly important in Canada.

The fact is, auditing is part of a range of services that fall under public accounting -- the process of providing independent assurance that an organization's financial statements are a fair presentation of its operational results, cash flows and financial position.

Management's integrity is critical to the financial reporting process, and the most efficient audits are those where management and the auditor recognize and respect each other's responsibilities. Under these conditions, the relationship between management and auditor enables auditors to do their work effectively and efficiently, creating an environment that leads to reliable financial reporting. All parties, including investors, benefit from this approach.

Most audits are co-operative exercises involving management, the auditor and the audit committee. The auditor neither assumes that management is dishonest nor assumes unquestioned honesty, but performs the audit with an appropriate amount of professional scepticism, in accordance with prescribed auditing standards.

Audits can and often do detect frauds. But they are not foolproof, and it is very difficult for an auditor to find a fraud if senior management colludes to provide the auditors with information that is incomplete, misleading or actually fraudulent.

In its January, 2006, study, *Auditing: A Profession at Risk*, the U. S. Chamber of Commerce succinctly summarized the challenge facing auditors with regard to fraud: "While auditors cannot eliminate the risk of fraud, they are inevitably blamed when it occurs -- even when it is the auditor who ultimately uncovers the fraud. This is a standard that no law enforcement agency could meet."

In recent months, the entire global financial industry was shocked when a wide range of investments, particularly securitized investments based on mortgages, turned out to be worth far less than originally assumed. Bankers, securities regulators, governments, ratings agencies, investors, the general public and, yes, auditors were all taken by surprise.

However, it would be a major error to lose faith in the audit process because it cannot always detect a fraud or predict an unexpected, massive change in the world economy. In the vast majority of circumstances, the independent assurance provided by auditors is both reliable and valuable. Moreover, our economy cannot function effectively without auditors providing assurance and guidance for owners, investors and the public at large.

That said, the public interest demands that auditors and audit firms commit to continually reviewing and improving their processes, as must national legislators and financial regulators. Of particular importance will be ensuring that the audit process is overseen by professionals who meet the highest standards of qualification and conduct.

In most of the major industrial nations, legislated standards for who can practise public accounting are set at national levels recognized by International Qualifications Appraisal Boards or their equivalents, because that allows for reciprocity agreements between accounting bodies in different nations. Through this process, Canada's CA profession has established mutual recognition agreements with the leading accounting bodies in the United States, the United Kingdom, France and elsewhere.

These mutual recognition agreements are very much in line with the recommendations of the Competition Policy Review Panel, which has called for Canada to harmonize its professional standards with those of the United States, to safeguard this critical trading relationship.

However, unlike our major trading partners, Canada has never set national standards for qualification and conduct with respect to public accounting. Legislation does exist in some provinces, but otherwise it is a "patchwork quilt" ranging from standards matching international requirements in Ontario and Quebec (the standards all CAs in Canada must meet), to lower or, in some cases, no legislated standards whatsoever in other provinces. This is a situation that exists in no other major country.

At a time when the resiliency of the global financial system is in question, Canada can no longer afford to have a patchwork system that calls into question our commitment to ensuring public accounting excellence. As a first step toward renewing and improving public accounting in this country, it's time for all provinces to legislate standards to the internationally accepted norms found in the United States, European Union and other leading economies.

--- - Brian Hunt, FCA, is President and CEO of The Institute of Chartered Accountants of Ontario.