

**Remarks by Gordon Thiessen, Chairman of the Canadian  
Public Accountability Board,  
To the IFAC Ethics Committee**

Brussels, October 11, 2005

Thank you for inviting me to the important meeting you are having here today. Since my background is in economics and central banking and my involvement in the world of accounting is quite recent, I am not proposing to offer you specific comments on your code of ethics and independence standards. However, I can offer some comments on the issue of ethics and independence from a more general perspective that I hope will provide you with some interesting and useful background and context for your discussions.

You probably do not need me to tell you that the difficult and time consuming work you are doing is crucial, not just for the accounting profession, but also from the standpoint of how our financial markets and our capitalist economies function more broadly. This broad role for accountants is reflected in the first paragraph of your code of ethics.

I was delighted when I first read: "A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer."

As Chair of the Canadian Public Accountability Board, my role is to oversee the regulation of auditors of public companies in Canada. So what I have to say to you today is, therefore, very much focused on the role of auditors as opposed to the work of accountants more generally.

I find that when I speak to various audiences in Canada, they do not fully appreciate the crucial role of auditors. Indeed, it is not always clear to me that all the accountants that I speak to are fully aware of their broad responsibility.

I am sure that you all realize just how important efficient financial markets are to a productive and prosperous market economy. And for financial markets to be efficient, there needs to be financial information that investors can depend on as presenting a fair and reliable statement of a share issuer's or a debt issuer's financial position. Similarly, lenders, such as banks, seek a comparable assurance with respect to the financial position of their corporate borrowers.

The reliability and availability of financial information is typically based on the application of sound accounting standards and extensive disclosure requirements. But if the integrity of that process is going to be assured, it needs to be assessed by independent, expert and trustworthy external auditors working to high quality auditing standards.

This crucial contribution of auditors to the operation of our financial systems was, for the most part, carried out appropriately over many years. The setting of standards by the profession, the self-regulatory institutes of accountants, and the importance of reputation for individual audit firms' business success all helped to make the system work.

But it was not a robust system. This became apparent during boom times when the potential of large share price gains put pressure on public companies to show continuous earnings growth. And auditors could then find themselves being asked to acquiesce to inappropriate accounting in order for the company to appear to have achieved this growth. Accounting firms are private, profit-making entities that need to maintain their client base if they are going to survive. This can make it more difficult than it should be from a broad public interest point of view for auditors to say no to a client on an accounting matter, even when that is the right response.

Good audits are a form of public good, to use the language of economists. Audits are a public good in that they provide benefits to the operation of financial markets in general and not just to the board of directors and the shareholders of the company being audited. To help ensure that audit firms take account of the broader public requirements that I have mentioned, and which you indicate in your code, I believe that all countries need a form of public oversight of and support for auditors.

That is where the Canadian Public Accountability Board and the increasing number of counterparts in other countries play a role. We require audits to be done to high quality standards. We monitor the enforcement of independence standards. We provide support to auditors who say no to inappropriate accounting by their clients. And we impose restrictions and sanctions on audit firms who do not fulfill their function thoroughly and ethically.

We find that our ability to perform our oversight function is much easier and effective when we have a cooperative relationship with the audit firms we inspect. A major influence on this relationship is the tone at the top of the audit firm. If the firm is committed to quality audits done by independent and ethical audit partners, our concerns diminish and our comfort level goes up. If we do not find that tone at the top, our inspections are going to be

more intrusive and we will be more likely to impose requirements and restrictions to ensure that the public interest will be protected. We believe that accounting firms should also look at the tone at the top of their audit clients to assess the risk involved and the nature of the audit required. The poorer is the tone at the top in client companies, the more detailed and questioning the audit needs to be. In cases where ethical standards are lacking at client companies, we support audit firms that are prepared to drop such clients.

One hopes that such actions by auditors will bring firms with poor ethical standards to their senses. Indeed, among business enterprises in general, the need for good ethics, integrity and trust is much more important than we typically appreciate. Market economies will work without integrity and trust, but they will not work well. And the resulting overall economic situation will not be as productive and prosperous as it could be.

In a world without integrity and trust in business, every economic transaction becomes potentially high risk. More due diligence needs to be done on a transaction to uncover any possible fraud and much higher risk premiums will be required before business takes place. This leads to markets that are less competitive, interest rates that are higher and stock prices that are lower. It also leads to more rules and regulations to prevent abuses and thus more constraints on entrepreneurial activity. The resulting negative impact on investment and productivity is evident.

If you doubt what I am saying, just look at those developing countries where integrity and trust are missing and corruption is rife. Local businesses that prosper in such circumstances do so for the wrong reasons, and are not a source of progress and expansion for the economy. And foreign companies and investors are deterred from pursuing potentially attractive investments because of the costs and uncertainties in such a culture.

Even in industrial countries, we have not been as aware of the importance of integrity and trust, as we should have been. The recent high profile corporate scandals in a number of countries were vivid evidence of the costs that can be inflicted when integrity fails. I am in the midst of reading the book, "The Conspiracy of Fools", which is the Enron story. I do not know just how accurate the author is, but the ethical lapses described in that book are nothing short of mind-boggling. As well, the regulatory response to these scandals should remind us of the pressures for restrictive laws and regulation that can develop when, as a society, we lose our confidence and trust in the business community.

An ethical culture of integrity and trust does not eliminate the need for rules to prevent abuses, but it should reduce the rigidity and invasiveness of the rules and the quantity of resources devoted to enforcing them.

The issue of ethics also has implications for international commerce. A comparable ethical culture in the business communities of national economies contributes to international trade and international financial transactions. There may well always be some risk premium attached to doing business in and with a foreign country because there are differences in law and business culture. But to the extent that we can minimize the differences in ethical standards, trade and financial flows will be facilitated, and economies will be better off. While we economists have not always been successful in persuading the general public of the benefits of international trade, there is no doubt in the economics profession that it is the quickest and most effective way of raising national living standards.

Let me come back to the accounting world. I cannot emphasize too strongly the value to auditor oversight agencies like ours of common or comparable standards for accounting, auditing, and ethics and independence across countries. It may not be possible or practical to persuade all countries to adopt international standards. But we need to work hard to achieve as much harmony as possible between national and international standards.

Let me give you an example of why that harmony is so important. Given the growth of international trade and financial flows, as I just mentioned, we cannot help but be vividly aware of the influence of globalization that is underway in almost all countries and markets these days. As a result, many companies have operations in countries outside their home base. Accountants auditing such a company need to rely on the overseas accounting firms that audit its subsidiaries. And when we, as audit oversight agencies, are inspecting a domestic accounting firm, we are going to want to look at the audit files of their clients with international operations because these are often complex and difficult audits.

In a world of high quality, globally-comparable standards, enforced by auditor oversight agencies of similar rigour, we would be able to rely on the quality and independence of the audit work done elsewhere without the cost and inconvenience of going overseas to check the work to see if it is acceptable. Where language differences exist, this checking process can be very unreliable. We are some way from achieving this ideal, but I look forward to arrangements with our counterpart auditor oversight agencies in the more advanced countries to help us deal with this issue of multinational firms in a more effective and less costly manner. In fact, audit oversight

agencies are meeting in London next week to discuss such issues of cooperation.

I also want to say a few words about the process for establishing and approving professional standards for accountants? I think there is no question that professional accounting bodies, like IFAC, need to do the work on technical audit and audit quality standards and on ethics codes and independence standards. No one else understands all the issues that accountants can confront. That is why I am persuaded of the value of the difficult and sometimes frustrating work on independence standards being done by your committee.

That being said, the days of complete professional self-regulation for accountants have come to an end in many countries. Already the special and difficult role of auditors in acting in the broad public interest has led to the development of auditor oversight agencies independent of the profession. The same developments are occurring with respect to the oversight of standard setting. The broad public interest is so important in all these standards that some more independent groups, which can represent this public interest more evidently, are needed to give the final approval to standards. And I know that IFAC has been involved in creating the Public Interest Oversight Board for this purpose.

I have to tell you frankly that the most effective way of bringing the public interest to bear is not yet completely clear to me. Who is most equipped to speak for the public interest? What is the role of governments? What should be the involvement of auditor oversight agencies in standard setting? Some national agencies are directly responsible for standards or their oversight. Other agencies like mine have a more indirect involvement.

There is not doubt that this is a very complex issue. Taking account of the public interest makes the standard setting process more time consuming. And we have to be careful that the process does not become so cumbersome that it is always running well behind the changing world. Various approaches are being tried nationally and internationally, and it will be important to assess which ones work most effectively.

I hope that accountants do not regard this desire for more public oversight with concern or resistance. It simply reflects the important role audits and auditors play in financial markets and in economies more generally and the need for society to ensure that the appropriate incentives and arrangements are there for the broad public interest to be recognized as accountants carry out their professional duties.

But how do we move from developing and approving ethical standards to having those standards widely accepted and acted upon? The work you are doing to promote your code of ethics with professional accountants is exactly what is required. We find that independence standards are not always taken as seriously as we think they should be. Moreover, we also need to persuade individual accountants that it is the spirit and principle of standards that need to be adhered to. In our work, we at times encounter a mind set that unless something is explicitly and specifically prohibited, it must be acceptable. Codes of ethics will not work if that is the attitude.

We also need to demand high ethical standards from those we deal with. In the case of accountants in professional practice, you need to demand that your clients operate with high standards as well. Indeed that is in your own self-interest. The risk of something going awry is much greater with a client who is prepared to engage in unethical behaviour. And we know that when businesses fail in such circumstances, audit firms can be left before the courts facing an unpleasant and potentially costly liability case.

I have made the same points with respect to ethics in presentations to business CEOs and senior officers more generally. Not only is it important for them to set high ethical standards and to maintain them within their companies, but they should also demand high standards from the people with whom they do business. The more we all act ethically and demand that others do the same, the better our economies and financial markets will function. We will have fewer restrictive laws and regulations; we will have lower interest rates and lower equity risk premiums; we will have more extensive international trade; and all that implies more prosperous economies.