

Regulation of the Accountancy Profession



**International Federation
of Accountants**

The IFAC Mission

To serve the public interest, the International Federation of Accountants (IFAC) will continue 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.

This Policy Position has been prepared by IFAC.

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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.¹ 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.²
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.³ 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

¹ This position paper addresses only the regulation of the accountancy profession, and does not address the regulation of other components of the financial reporting supply chain.

² The generic term in economics for situations where regulation is deemed necessary to ensure market efficiency is "market failure." Market failure can arise for a number of reasons, and does not necessarily mean there is either a lack of competition within the market or failure (including anti-competitive behavior) on the part of market participants. Generally, professional services are subject to some form of regulation given the nature of the services, as they give rise to the generic issues described in paragraph 12-14.

³ Competition in a market is, generally, a powerful force in driving improvements in product or service quality and value. The market for accountancy services is clearly one mechanism to ensure overall quality and consistency as professional accountants compete to offer the best value services. For this reason, most economies have in place laws or regulations to protect competition. This area of regulation is not the subject of this policy position and in fact there appears to be active competition in the market for accounting services.

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.⁴

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.⁵

⁴ The technical terms for these two types of market failure are information asymmetry and externalities, respectively.

⁵ Within economics it is also recognized that “government failure” can occur. The existence of actual or potential market failure does not necessarily mean that regulation improves the position. Regulation can, for a number of reasons, make a situation worse. This might occur where compliance costs are markedly higher than estimated, or there are serious unintended consequences. The objective of public policy is to design regulatory systems that address market failure without causing government failure, and thereby increase the well-being of the economy and society.

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 government⁶ 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

⁶ In this paper “government” refers, as appropriate in the context, to all the branches of government, including the actions of the legislature (in establishing legislation) and the executive (in monitoring and enforcing compliance with legislation and regulations).

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.⁷
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

⁷ IFAC considers that whatever the balance in a particular jurisdiction, the outcome is more likely to be positive if there is a collaborative and mutually respectful relationship between the parties.

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;⁸
 - 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.

⁸ Whether the regulation is conducted by a professional institute or by a government or independent agency, the monitoring should encompass the adequacy and quality of the resources available to the organization.

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.



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