

Board of Governors of the Federal Reserve System

Speech

Vice Chairman Roger W. Ferguson, Jr.

(on February 16)

To the Financial Stability Forum, International Accounting Standards Board, and International Federation of Accountants Roundtable on Financial Reporting and Auditing, Paris, France

(via videoconference)

It is a pleasure to join you for this joint Roundtable on Financial Reporting and Auditing. As chairman of the Financial Stability Forum, I would like to express my appreciation to all of you that are participating in this roundtable as distinguished speakers or in other roles. In addition, I appreciate the very good partnership that we have had with the International Accounting Standards Board (IASB) and International Federation of Accountants (IFAC)), and with our host, the World Bank, in preparing for this gathering.

Since our last joint Roundtable in October 2004, much has transpired in the international accounting and auditing arenas. Indeed, 2005 was a very big implementation year for international standards around the world. The topics of this Roundtable--dealing with the experience of implementing IASB and IFAC standards and related regulatory challenges, international convergence and harmonization, issues associated with using fair values in the financial reporting model, and risks and vulnerabilities arising from the financial reporting chain--all reflect the interconnectedness of accounting, auditing, and regulation and the need to consider these issues from the unique perspectives that all of you bring to the table. It is very important that this type of constructive dialogue continues to take place among the many key stakeholders in the financial reporting chain.

The focus of the roundtable--international financial reporting and auditing--continues to gain increased attention from members of the international regulatory community such as the Financial Stability Forum, the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), and the Basel Committee as well as from national supervisors, standards setters, banks, investors, analysts, auditors, and many others. As we all know, in recent years, accounting and auditing scandals and other developments have found their way onto the front pages of your daily newspapers in ways rarely seen before. These challenging developments have led to a new resolve on the part of governmental, regulatory, and business leaders that there must be a reinforcement and improvement of standards-setting processes and a return to sound accounting, auditing, and disclosure practices by companies and their auditors.

The unprecedented problems of a few years ago fueled efforts to help restore investor confidence in U.S. and European capital markets through legislative reforms affecting both the accounting profession and corporate management and directors. For example, these efforts led to, for example, the enactment of the Sarbanes-Oxley Act in the United States which set the stage for a new audit oversight authority--the Public Company Accounting Oversight Board--to regulate, inspect, report on, and in some cases enforce penalties against auditors and led to new requirements for corporate management to maintain strong internal controls and to make periodic public reports on the adequacy of their companies' internal controls. In the European Union, the Eighth Directive and other initiatives were undertaken in recognition of the important role of audit oversight authorities. These initiatives seek to strengthen accounting standards, internal controls, and transparency.

But long before these legislative initiatives were being considered, steps were taken to establish independent international standards-setting frameworks for both accounting and auditing standards, as reflected by the creation of the IASB in 2001 and the IFAC International Auditing and Assurance

Standards Board (or IAASB). Both of these standards-setting processes have been reviewed and enhanced over time and continue to be subject to improvements.

In his keynote speech earlier today, Michel Prada shared with you IOSCO's initiatives to address international accounting and auditing issues. It is clear that IOSCO has played a very important role in these arenas for many years. Likewise, central banks and banking supervisors have taken steps to enhance their focus on accounting and auditing matters that affect institutions they supervise. During the mid-1990s, the Basel Committee started to devote more resources to developing principles that would help shape and improve bank disclosure, supervisory reporting, and accounting practices. Moreover, the committee recognized that it was also important to support high-quality standards-setting processes. With the formation of the Accounting Task Force by the Basel Committee in 1997, the Basel Committee began to participate more actively in processes for setting accounting and auditing standards. This participation led to the development of enhanced accounting guidance on financial instruments and more comprehensive bank audit guidance. The IAIS has also shown a strong interest in the development of sound international accounting and auditing standards, as evidenced by its participation in the IASB's Insurance Working Group and the recent Group of Thirty (G-30) effort to enhance the transparency of reinsurance activities.

All of these positive efforts by regulators and supervisors reflect a growing recognition that sound accounting policies and meaningful public disclosure by banking and other financial organizations and by nonbanking companies can improve market discipline. With sufficient, accurate, and relevant information, market participants can better evaluate counterparty risks and adjust the availability and pricing of funds to promote better allocation of financial resources. Thus, more-effective market discipline can, in a sense, "regulate" the risk-taking activities of banks and other firms in ways that can complement supervision and regulation of financial institutions and foster stable financial markets.

The concept of market discipline has assumed greater importance among international banking supervisors with the publication of the new International Capital Framework, called Basel II, which seeks to strengthen the market's ability to aid bank supervisors in regulating capital adequacy. As you know, in addition to pillars on risk-based capital requirements (pillar 1) and risk-based supervision (pillar 2), Basel II includes the very important pillar 3, which addresses disclosure of risks and capital adequacy to enhance market discipline. This approach to capital regulation, with its market-discipline component, signals that sound accounting and disclosure will continue to be important parts of the global bank supervisory approach for many years to come.

In addition to disclosure and market discipline, supervisors and regulators around the world recognize the need for stronger audit and control standards for financial services firms and other companies. The quality of management information and supervisory and financial reporting is dramatically affected by internal control systems, including internal audit programs and reviews by external auditors. Sound supervisory and financial reporting, good internal controls, and quality audits are becoming more important to financial services regulators because they directly affect regulators' ability to promptly identify institutions in distress and work toward a satisfactory resolution.

This shared understanding of the importance of sound audit and control practices led to an unprecedented level of cooperation among the international regulatory community--in this case, IOSCO, the Basel Committee, the IAIS, the European Commission (EC), the World Bank, and the Financial Stability Forum, which came to be known as the Monitoring Group. Working together, they were able to develop a common position on reforms. This common position served as a basis for dialogue with the leadership of IFAC about establishing a credible independent oversight authority to help enhance the integrity and objectivity of the IAASB's international audit-standards-setting processes. This led to the creation of the new Public Interest Oversight Board of IFAC, which is now busy assuming its new responsibilities. The Public Interest Oversight Board (PIOB) should, over time, lead to enhanced audit standards and practices around the world. The Financial Stability Forum is pleased to have been a strong supporter of this initiative, and I am happy to see that the PIOB is represented at this roundtable today together with the leaders of IFAC and many

Monitoring Group representatives.

The Financial Stability Forum has taken a close interest in national and international efforts to strengthen confidence in financial reporting frameworks. Stronger and more-convergent national systems bring clear financial stability and efficiency benefits. The forum's efforts have included a focus on the global-standards-setting activities of the IASB on the accounting side and the IAASB on the auditing side. The goal of global standards in both areas will require a high degree of convergence between U.S. and international standards, and efforts toward full commonality are well underway. The forum's interest reflects the strong recognition of its members that the potential financial stability and efficiency benefits are significant: high-quality global accounting standards can lead to enhanced transparency that will improve market discipline and foster stable financial markets. Likewise, external audits performed in accordance with high-quality global audit standards can ensure that financial statements are reliable, transparent, and useful to the marketplace, thus enhancing market confidence.

I am sure that we all want to see, over time, a restoration of public confidence in the quality of financial reporting and auditing, and I hope that dialogue--such as that taking place at this roundtable--and the initiatives of standards setters, can lead to standards that are fully understandable to preparers, users, and auditors; that avoid undue complexity and implementation costs; and that truly contribute to transparency. Let me also stress the need to continue to implement approaches that not only improve international accounting and audit standards, but also encourage, through the implementation and enforcement of these standards, an enhancement in actual international accounting and audit practices.

However, like any professional undertaking, developing accounting and auditing standards and practices can be complicated, and gaining a shared understanding of the implications for the financial reporting chain and for financial stability can take time. Therefore, I am pleased to see that the Financial Stability Forum, the IASB, and IFAC conducted this roundtable on important financial reporting and auditing matters and that you are taking the time to contribute to the exchange of valuable information on key issues. I hope that this roundtable will continue to foster constructive dialogue among the many key stakeholders represented here and that this type of dialogue will continue after the roundtable has ended.

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