

Principles v rules

Everyone agrees that principles are better than rules and the debate has moved on. The real challenge is in finding the optimum level of detail to improve audit quality. **Katharine Bagshaw**

Many regulators, preparers, auditors and users of accounts think that accounting and auditing standards should have more principles and fewer rules. But the rulebooks seem to grow ever thicker.

There are many reasons for this, some of which are behavioural. People are reluctant to abandon rules once they are in place for fear of encouraging the real or perceived mischief they were designed to deal with. Principles are even harder to shift because they should be robust and enduring. Changing or abandoning them implies that we got something wrong in the first place and doesn't feel right.

Principles and rules also proliferate because they are open to interpretation. Novel situations arise leading to ever more guidance and ever bigger rulebooks. Only when large parts of them become redundant, ineffective, counterproductive or impossible to police is there serious consideration of getting back to basics. And that is sometimes after a great deal of damage has been done.

Viewpoints

The Audit Quality Forum publication *Principles-based Auditing Standards* looks at this problem in the context of auditing standards. It recognises that major obstacles to more principles-based auditing standards are differences in views across jurisdictions on the purpose of the audit, the role of auditors, and differences in the education and training of auditors and regulators. The effect of differences in the litigation risk should not be underestimated.

Language differences compound these problems. Attempts to define principles have not been successful, probably partly because even good quality dictionaries describe rules as principles, and vice versa. Attempts to translate, into languages other than English, the words 'principles', 'rules' and 'objectives', and the associated

obligations of 'shall' and 'must' in auditing standards, drive the whole debate into a quagmire.

Two concerns have emerged. Firstly, auditing standards written primarily to enable regulators to regulate, rather than to enable auditors to audit, are poorer auditing standards. The influence of some regulators in the audit standard-setting process in recent years may have been excessive. In particular, some regulators who may not be as well-established, funded or trained as those in the UK, have called for more detail in auditing standards to enable them to perform their work better. They may also have little experience of principles-based auditing standards or oversight. Secondly, some auditors have unacceptably sought to preserve the old order when change is clearly needed in the light of accounting scandals and audit failures.

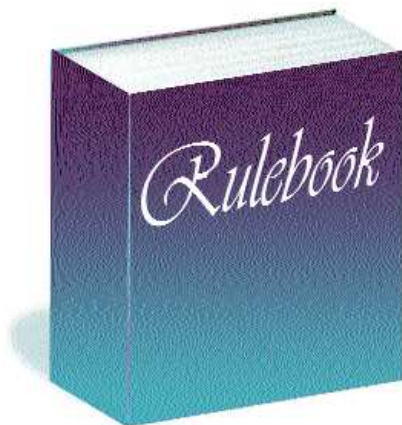
In reality, there is only one question: where to draw the line. How much detail is needed in auditing standards? On the one hand we would all like thinner rulebooks. On the other, we all tend to ask for more guidance when we feel uncertain and exposed in the face of difficult issues. How can we achieve our aim without making everyone feel uncomfortable?

Optimism

Principles-based Auditing Standards examines some of the cultural and structural issues surrounding these problems. It explains the relationship between auditing standards and audit quality, the role of judgment and the importance of professional integrity in underpinning principles-based auditing standards. Most people, after all, are more concerned about the ethical standards of auditors than they are about the technicalities of auditing.

Most importantly, the report is optimistic that the proliferation of rules in auditing standards is not inevitable and that a better balance between principles and rules can be struck provided that the desire for mutual understanding among stakeholders and enhanced audit quality are not lost.

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Find *Principles-based Auditing Standards* at www.auditqualityforum.com
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