

**International Organization of Securities Commissions
Technical Committee**



OICU-IOSCO

**Technical Committee Paper: Contingency Planning
for Events and Conditions Affecting Availability of Audit Services**

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Executive Summary

The IOSCO Technical Committee has developed this paper to assist IOSCO members in considering and preparing for potential contingencies that may arise involving audit firms and that may affect the delivery of audit services in the global capital markets. It presents a collection of information about issues and experiences encountered in past events and conditions that affected the auditing of financial statements of public companies. IOSCO members are encouraged to consider the information in this paper to anticipate and prepare for events and conditions that may affect the delivery of audit services in the capital markets. Members are also encouraged to consider the possibility of international impacts that may arise in a contingency situation and to communicate with other regulators and affected parties to the extent possible. Aids for such communication are discussed in this paper.

This paper sets forth suggested matters for consideration, rather than specific principles or prescriptions, because the legal frameworks, powers and responsibilities of securities regulators differ among IOSCO member jurisdictions. Legal constraints regarding confidentiality may also be different and can affect the ability to have communications with other interested parties.

The individual facts and circumstances of each contingency situation will be unique and will necessitate a plan tailored to that event or condition; however, use of preplanning and preventive measures can help to reduce risk of a crisis and can also facilitate speed and effectiveness in response if a crisis arises.

Key topics discussed in this paper and its appendices include the following:

Need for Contingency Planning The independent audit function is a contributor to investor confidence in the capital markets. A contingency situation involving an audit firm can temporarily disrupt the normal operations of the audit function in a capital market. Disruptions in the availability of audit capacity and audit services can also occur on an international scale if a global audit firm is involved in a contingency that develops into a crisis. By anticipating issues and conditions that may arise and creating securities regulator contingency plans, IOSCO members can seek to minimize potential disruptions and thereby support confidence in the markets.

Planning and Preventive Measures Effective contingency planning involves consideration of issues and potential action plans on a dual track that focuses both on advance planning, including preventive measures, and on contingency management, that is, processes and tools to put into effect when an actual contingency situation has developed. Engaging in informed dialogues with relevant persons, authorities, and entities in advance of contingency situations can raise awareness of risks and factors that contribute to occurrences of contingencies and/or crises, and thereby encourage all parties to consider contingency planning.

Crisis Management Crisis management involves gathering information on a timely basis and assessing the impact of events and conditions on the availability of audit capacity and audit services. It includes the timely development and execution of action plans and the

provision of relevant and timely information to others with due regard for confidentiality obligations.

Communications and Confidentiality Regulators may wish to consider the need to communicate with affected parties and other competent authorities during a crisis and notify investors that regulatory authorities are dealing with the crisis appropriately. Legal constraints regarding confidentiality should be duly taken into account. IOSCO members may wish to consider establishing communications protocols before a crisis arises. The facts and circumstances of each crisis will affect the nature of information a regulator would find appropriate to share with others.

1. Introduction

1.1 Focus and Form of the Paper

Securities regulators can seek to minimize and manage potential disruptions to the availability of audit services and threats to investor confidence in times of a global audit firm contingency and/or crisis by creating plans for use during such situations . The IOSCO Technical Committee member jurisdictions have developed this paper to facilitate consideration of the issues involved in contingency planning.

The focus of the paper is on the international aspects of contingency planning as well as domestic issues and considerations. Because of the multinational and interdependent nature of investing and corporate capital raising, and the existence of global audit firm networks, an audit firm contingency or crisis in any IOSCO member jurisdiction has the potential to affect the delivery of audit services in other member jurisdictions. The cooperative philosophy and mechanisms that exist in IOSCO can provide a framework that will assist IOSCO members in contingency planning.

This paper provides information on possible measures that may be useful in minimizing the risk of disruptions to the capital markets caused by an audit firm contingency affecting audit availability. The paper also provides suggested considerations for crisis management for events and conditions that may arise if a contingency develops into a crisis. The paper sets forth considerations rather than specific principles or prescriptions because the legal frameworks, powers and responsibilities of securities regulators differ among IOSCO member jurisdictions.¹ Legal constraints regarding confidentiality should also be duly taken into account. A securities regulator's precise course of action will depend upon the legal framework of the jurisdiction and the particular facts and circumstances of the situation involved. Appendix 1 provides a generic contingency planning template that may be helpful in assisting IOSCO members in creating contingency plans.

1.2 Effects of Market Concentration and Integration of Audit Firms

This paper provides guidance with the goal of helping regulators diminish the risks and mitigate damage that might result from an audit firm contingency or crisis. Increased concentration within the audit market and increased integration within audit firms may negatively affect the availability of audit services in a crisis and/or make quarantine of a crisis more difficult.

The growth in audit firm concentration since the 1990s can limit choice and availability of audit services in some circumstances, particularly in the case of audits of large multinational issuers. With less choice for alternative auditors, the potential loss of one of the remaining large global

¹ The paper also acknowledges that in some jurisdictions, the securities regulator has few or no responsibilities regarding auditor oversight and does not intend to make suggestions on the allocation of auditor oversight responsibilities on the national level. Rather, it addresses securities regulators only so far as they have a role in auditor oversight.

firms could further affect availability of audits for large, global companies and thereby have a potential effect on investors. It is also possible that structural and operational integration within a global firm may affect the spread of the effects of a crisis.

Notwithstanding these factors, this paper does not intend to suggest or to make a presumption that any audit firm is “too big to fail.” The intent of this paper is to focus on maintaining availability of audit services under all conditions and to be neutral as to continuity of any particular audit firm.

While an audit firm crisis culminating in a temporary or permanent market exit of a major firm could create the need for transition of auditors to other firms and potentially further reduce audit choice in a market, it is possible that at times an exit may be unavoidable or even desirable from a regulatory and investor protection perspective. Sanctions that lead to a cessation or suspension of a firm’s operations may be appropriate in certain situations, and in any event, may not be within the control of securities regulators. In the case of a permanent or temporary exit of a firm, securities regulators will want to consider if any measures are needed to provide orderly transitions and continued availability of audit services to support investor confidence.

2. Events and Indicators that May Precede a Contingency or Crisis

A wide range of conditions and events may generate contingencies involving auditors. At one extreme, a catastrophic financial fraud involving complicity by auditors may lead to criminal charges against an audit firm, which could potentially trigger a crisis that includes the demise of the firm. Litigation from shareholders may result in significant financial losses, the terms of which may also impair an audit firm’s financial condition and viability of operations. In addition, in cases of audit firm malfeasance or gross negligence, some regulators may seek to bar a firm from practice or revoke its license. At the other extreme, litigation over alleged financial reporting and audit failures may occur and each incident does not necessarily create a contingency or crisis condition for an audit firm. While many types of precipitating events are identifiable, others may exist that cannot be predicted.

There are many types of conditions that may give an indication of a possible contingency or crisis involving an audit firm; however, some of these conditions may arise and not precipitate a crisis. Signals of a possible contingency situation may arise from one or more of the following:

- Institution of a criminal proceeding against an audit firm charging audit failure;
- Institution of a major civil proceeding against an audit firm
- Discovery of a major financial reporting fraud or illegal act at an issuer company;
- Discovery of a material misstatement in financial reporting at an issuer company;
- Discovery of widespread or significant independence violations in an audit firm;
- Discovery of auditor complicity in fraud or other malfeasance in an audit firm;
- Whistleblowing or media reports alleging improper performance of auditors;
- Announcement of a major restructuring of an audit firms (*e.g.*, mergers and acquisitions, spin-offs, separations, etc.).

These types of events, particularly if the cases are severe and have broad impact, , can conceivably lead to an undermining of the confidence of investors in the audits of subject firms and/or the permanent or temporary exit by an audit firm from the market. An audit firm could also choose to leave the market because of conditions not precipitated by a crisis event. A voluntary exit not precipitated by a crisis, however, can result in a crisis in availability of audit services if there is significant concentration in an audit market and arrangements are not made for an orderly transition of auditors and audit capacity.

3. Dual Track for Contingency Planning

Effective contingency planning involves creating, evaluating, maintaining and executing action plans on a dual track of preventive measures and crisis management. The " preventive measures" track involves activities that a regulator may consider undertaking on a regular basis, in coordination with other competent authorities, to support audit quality, bolster audit availability, and monitor the likelihood of events that could lead to market disruptions that threaten investor confidence. The “crisis management” track relies on the regulator’s advance preparation of an action plan for use in a contingency situation that develops into a crisis. Crisis management also includes gathering information and evaluating and updating whatever plan has previously been prepared for use should a crisis arise. Appendix 1 includes a generic template that regulators may find useful in creating and customizing a contingency plan.

4. Preventive Measures and Development of Contingency Plans

Ongoing communications of an educational and information-sharing nature with relevant persons and entities in advance of any contingency or crisis can improve regulatory awareness, coordination and the ability to act quickly. Communications may focus on improvement of audit quality, relative responsibilities, how the actions of one authority may affect other authorities or the capital markets, and the value and substance of contingency planning.

Each regulator may wish to consider creating a customized contingency plan for use in the local jurisdiction, employing the template provided in Appendix 1 if desired.

On a longer-term basis, possible changes to the legal and regulatory landscape might be considered for the purpose of promoting financial reporting and audit quality, facilitating choice in audit services, and/or reducing the risks of an audit crisis. Examples of such legal and regulatory considerations are included in Appendix 2 of this paper.

4.1 Ongoing Communications with Auditor Oversight Authorities, Auditors, Professional Organizations and Standard Setters

IOSCO member regulators may wish to consider undertaking ongoing communications with auditor oversight authorities on measures that promote audit quality and auditor accountability. IOSCO members may also wish to consider engaging in dialogues with auditors, auditor professional organizations, and audit standard setters on measures to promote audit quality and

reduce risk of an audit crisis. Factors to discuss could include enhancement of audit quality, establishment of auditing standards, audit firm compliance with standards, audit firm policies for quality controls and for managing engagement risk, and how audit firms monitor, verify and enforce compliance with standards and policies.

To obtain awareness and to provide a regulatory perspective on changes needed to enhance the quality of standards, under the assumption that high quality standards contribute to high quality audits and thus minimize the potential of audit crises, regulators may consider communicating on a regular basis with domestic and international professional organizations and standards-setting bodies. To encourage high quality in international auditing standards, IOSCO regularly comments on proposed International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). IOSCO comment letters are posted on the IOSCO public website.

Regulators may have an interest in ascertaining whether audit firms and other organizations have considered risks of various contingencies that might occur and formulated contingency plans relevant to their areas of responsibility. Having an awareness of the extent of such risk assessment and contingency planning by others may inform the regulators' own planning. However, it is also possible that making inquiries about such contingency plans, especially plans of audit firms themselves, could create risks for regulators if such inquiries are mistakenly perceived to constitute approval by regulators of whatever information is shared.

Regulators should also be aware that involvement in the contingency planning or lack thereof by others may create expectations on the part of others that regulators are prepared to provide some type of assistance. Regulators can avoid misunderstandings if any communications with other parties are clear as to intent and scope, if such inquiries are conducted.

4.2 Ongoing Communications and Information Exchanges with Government Agencies and Others with Responsibilities for Investigation, Discipline and Sanctions

In IOSCO jurisdictions in which the securities regulator does not have sole responsibility for investigating audit failures and/or determining remedial actions or sanctions or for oversight of auditors, IOSCO members may wish to consider engaging other authorities in information exchanges regarding risks and potential effects of an audit firm crisis.

The existence of and responsibilities of various types of authorities may vary from jurisdiction to jurisdiction and therefore the relevance of their involvement in discussions relating to contingency planning may also vary. Examples of one or more authorities that may potentially be involved include:

- Auditor oversight authorities
- Ministries of justice
- Criminal authorities
- Exchanges and listing authorities
- Auditor licensing authorities

- Banking regulators
- Insurance regulators

While the legal framework of each country affects the nature and degree of what particular authorities can do in an audit firm crisis, an awareness of the range of choices among relevant authorities for sanctions and penalties may be helpful in minimizing negative effects on the capital markets. It may also be useful to exchange information on issues relating to timing and effects of sanctions and penalties and on how audit services can be transitioned and maintained if a crisis occurs.

Entities may wish to share information that would allow others to be aware of how their actions could affect or interact with those of other authorities and which other authorities may assist in furthering regulatory goals. Securities regulators may wish to explain their investor protection mandate and discuss the combined and individual effects the relevant authorities' actions can have on investors and the capital markets.

Possible topics for inter-authority discussion could include:

- Ability of an authority to dissolve an audit firm or require it to break up or divest portions of itself;
- Ability or inability of an authority to encourage or require actions that would facilitate the movement of auditors from one firm to another if a firm is suspended or is going into demise;
- Ability for an agency's sanctioning authority to put a firm out of the business of providing audits, for example, through revoking its license to practice or registration or barring it from practice before a particular authority in a jurisdiction;
- Authority or lack thereof over employment actions of firm employees and owners in the case of a firm demise;
- Sanctions available to a particular authority;
- Direct and indirect effects that may result from the measures taken, for example, effects of criminal charges against audit firms versus individual auditors;
- Ability or inability of an authority to coordinate timing of its sanction with that of other authorities; and
- Ability or inability of an authority to coordinate amount of financial penalties or disengagement with that of other authorities.

These same considerations can also be topics for coordination across jurisdictions with foreign regulators. They are also topics to consider in the context of crisis management.

4.3 Communications relating to Audit Committees and/or Others Responsible for Listed Company Governance

Securities regulators may wish to consider providing information for members of audit committees or directors responsible for corporate governance and appointment of a company's

external auditor and/or organizations that provide standards and guidance for those charged with governance.

Such information could include:

- The nature of the auditing environment from an issuer standpoint;
- The nature of regulatory actions and conditions that could give rise to sanctions against audit firms in a market;
- Actions that audit committees could take to promote audit quality and availability of audit services. Such actions could include identifying one or more other eligible audit firms to have in reserve if a change of auditor were to become needed, and avoiding actions that would preclude such an audit firm from being a candidate for that issuer's audit engagement;
- Desirability of contingency plans for issuers; and
- Lessons learned from audit failures, contingencies and/or crises in the past and in other jurisdictions.

4.4 Considerations for Possible Changes in Legal and Regulatory Framework

Regulators may wish to consider examining the extent to which a country's commercial, legal and regulatory frameworks provide support in encouraging high audit quality and availability of audit services. Regulators may also wish to consider how actions to promote greater transparency and enhanced governance may alleviate the risk or effect of an audit firm crisis. Appendix 2 to this paper provides a number of issues and alternatives for consideration and analysis by regulators who wish to explore possible changes in legal and regulatory frameworks in order to encourage audit quality and contribute in other ways to reduction in crisis risk.

Not all of the actions set forth in Appendix 2 would be possible or suitable for securities regulators in every jurisdiction, as the roles and powers of IOSCO members differ as well as the aspects of auditor oversight that may be shared or lie fully with other organizations in a given country.

4.5 Development of a Contingency Plan

To be well prepared for possible contingency and/or crisis situations, each IOSCO member jurisdiction is encouraged to create an appropriate contingency plan for their local circumstances, including a communication plan (see Section 6 below for considerations for a communications plan) and an up-to-date contact list. In developing a contingency plan, members may find it helpful to consider the generic template provided in Appendix 1 as well as other matters discussed in this paper. Each regulator's contingency plan will vary according to the securities regulator's role and authority.

5. Crisis Management

Many concerns will arise for the regulator to assess in managing an audit firm contingency that develops into a crisis event that has the potential to disrupt markets and affect investor confidence. Two paramount considerations will be (1) maintaining the provision of audit services to public listed companies, and (2) to the extent possible, providing relevant information on a timely basis to the public and interested stakeholders and assuring them that regulatory authorities are monitoring the situation and taking appropriate actions. Legal constraints regarding confidentiality of the information collected in the performance of supervisory duties can affect the ability to have communications with the public and other interested parties.

5.1 General Legal, Regulatory and Practical Matters that Have Arisen in Past Audit Firm Crises

There are a number of factors that can come into play and affect both investor confidence and potential disruption to availability of audit services in the capital markets when a crisis occurs. Securities regulators may wish to consider the following examples for potential use or applicability in their jurisdictions:

- Requiring or requesting a firm in crisis to notify the regulator immediately if market exit becomes imminent or probable. The securities regulator may want to keep abreast of factors such as:
 - The rate and number of client defections;
 - The firm's financial viability including its liquidity, credit and insurance situations;
 - Civil litigation that arises;
 - Partner defections;
 - Foreign affiliate defections; and
 - Whether the firm's quality control systems can be maintained throughout the crisis situation, and documented, if necessary;
- Taking steps to promote an orderly transition of issuers from a former auditor to new auditors;
- Considering whether successor liability exists in the jurisdiction and how it may affect an intention by the exiting firm's partners to form a new entity or to join an existing firm;
- If a firm plans to import auditors from another jurisdiction, necessary licensing procedures;
- Establishing appropriate communications systems (*e.g.*, phone hotlines, regularly scheduled conference calls) with affected parties (*e.g.*, investors, issuers, auditors) and other relevant authorities (*e.g.*, audit oversight authorities, criminal authorities);
- Handling press statements, for example:
 - Whether, and if so, when, the securities regulator should make a statement;
 - Whether a statement should be neutral in tone or espouse a particular position;
 - Who should make a statement (*e.g.*, the head of an agency, the agency itself, the chief accountant, or a spokesperson);
- Monitoring and analyzing market trends and participants' actions following crisis indicators and undertaking appropriate communications regarding the crisis's effects on

the market, such as the following:

- Behavior of issuers/audit committees who are clients of subject firm; and
- Actions of audit firm employees and potential employment at other audit firms.

5.2 Crises related to Criminal Prosecutions or Regulatory Actions

The following considerations may be relevant:

- With respect to sanctions, remedies, penalties, and settlements;
 - The nature of the action selected, its scope, enforceability and timing;
 - Direct and indirect effects that may result from the measures taken, for example, effects of criminal charges against audit firms versus individual auditors; and
- Whether, and if so how, to take measures to contain a disruptive crisis situation by:
 - Applying the sanction in a particular time period (*e.g.*, the least busy part of the audit season);
 - Allowing issuers to continue without an auditor during a temporary period in which its auditor is suspended from business or while the issuer finds a new auditor;
 - Limiting the sanction to less than the entire firm, if appropriate; and
 - Other containment strategies.
- Whether potential disruption in the availability of audit services is threatened significantly enough to warrant consideration of exceptionally accepting an audit firm's conditional continuation in the market under specific restrictions and conditions, which might include one or more of the following:
 - With potential modification of the firm structure or supervision;
 - With divestiture of certain partners, employees, clients, or practice groups;
 - With enhanced quality control and governance mechanisms;
 - With liquidity requirements to cover litigation and other costs;
 - With temporary government or government-approved supervision;
 - For a specific period to allow an orderly transition to unwind the firm and allow issuers to find new auditors and audit employees to find new employers; and
 - For specific and limited purposes such as signing completed audit reports that were not tainted by the crisis situation or signing completed audit reports for foreign jurisdictions.

This consideration of alternative measures should not be seen as intending in any way to prevent or limit judicial prosecution or regulatory actions. Due consideration should be given to avoiding a presumption that regulators will intervene to prevent an audit firm from exiting a market, as a presumption of this nature may introduce a moral hazard into the audit process. Consideration should also be given to the possible effects of regulatory activities on maintenance or flight of clients from a firm in crisis.

5.3 Considerations for Circumstances when Audit Firm Demise is Imminent

If an audit firm is clearly exiting the market, regulators will want to consider the consequences of a potential interruption of audit service delivery and possible actions to address those consequences.

Depending on the relevant legal framework examples may include:

- Whether to grant temporary relief on filing or reporting deadlines;
- Whether to grant temporary relief on requirements for filing of audited financial statements and whether in certain situations such relief might not be appropriate because of the nature of the filings;
- Whether to grant a special dispensation to the exiting firms' clients to operate without an auditor, or with a specially appointed auditor, for a temporary period immediately after the exit;
- Whether to suspend requirements for issuers or successor auditors to obtain information from the former auditor; and
- Whether to temporarily suspend or grant no-action with respect to auditor independence requirements;
- Whether to monitor that a firm's exiting clients take appropriate actions to appoint new auditors in a timely manner.
- Whether to facilitate that listed companies have an orderly transition to new auditors either by themselves or with the support of professional bodies or other organizations.

Regulators are cautioned to exercise care in granting exceptions and special dispensations, as their overuse could reduce the incentives for audit firms, issuers and others to make adequate contingency plans.

5.4 Additional Considerations for Other Affected IOSCO Member Jurisdictions

Depending on their nature and the nature of the subject firm, audit crisis events can affect investors and capital markets outside of the locus of the crisis. At the time securities regulators outside the jurisdiction in which the crisis event occurs become aware of the situation and need to decide on appropriate measures, they may wish to consider the following in determining potential ripple effects of the crisis on investors and issuers in their home markets:

- Could the crisis event cause the subject audit firm's local affiliate to cease or suspend business either voluntarily or involuntarily;
- Will the event prevent the local affiliate from signing audit reports for local and/or foreign issuers;
- Do partners or employees of the local affiliate have potential significant liability in connection with the crisis event;
- Is it likely that the crisis event will lead to an exodus of clients, partners and/or employees from the local affiliate;

- Does the local affiliate have a significant number of audit clients in the jurisdiction of the crisis event;
- Should the relevant local regulator inform other authorities in their jurisdiction of the circumstances (*e.g.*, criminal authorities, audit oversight authorities);
- Should the relevant local regulator inform local issuers and other securities market participants of the circumstances of the crisis;
- Should the relevant regulator inform the press regarding the circumstances of the crisis; and
- If the crisis stems from auditor behavior violating laws and regulations in the foreign jurisdiction:
 - Are any individuals in the local jurisdiction involved or potentially involved in the behavior;
 - Is the violative behavior the type that may also exist locally as a result of systemic global practices of the firm;
 - Should the relevant regulator conduct an inspection or investigation of the local affiliate or inform the local inspection authority of the circumstances;
 - If it has authority, should the relevant regulator bring an enforcement action based on information received from the foreign regulator where the crisis occurred.

6. Communications and Confidentiality Issues

In the event that a crisis occurs, the regulator may wish to consider the need to communicate with affected parties and other competent authorities. The regulator will also need to consider giving reassurance to investors that regulatory and other authorities are handling the situation appropriately. Intensive inquiries are likely to be received from news media. In crises affecting foreign issuers and markets, communication will need to occur across jurisdictions. Cross-border coordination of public messages may also be useful.

Securities regulators should balance the need for communication with its potential deleterious effects in certain contexts. While communications are essential in crisis management, regulators are advised to consider legal constraints regarding confidentiality, as well as other legal restraints to full communication. Uncertainty about unfolding circumstances will also necessitate caution. Regulators are also advised to weigh the efficiency of the mode of communication with respect to the sensitivity and confidentiality of the message to be conveyed.

6.1 Communications Planning

IOSCO members may wish to consider establishing communications protocols before a contingency or crisis event arises. Communications can be subject to confidentiality constraints and therefore such planning will take into account the relevant legal framework. In a specific crisis, one of the first actions should include updating previously prepared generic timelines and contact lists, both domestic and international.

Within IOSCO, communications may take place directly among involved and affected IOSCO members. IOSCO members may also wish to utilize the IOSCO Secretariat to facilitate

communications and/or to develop a contact list. The IOSCO Secretariat maintains mailing and email lists for all IOSCO members and for IOSCO committees.

A regulator's crisis action plan may include provisions for:

- Communication to relevant authorities that may include:
 - Foreign securities and other regulators;
 - Ministries of justice and other criminal authorities;
 - Exchanges and listing authorities;
 - Auditor oversight authorities;
 - Auditor licensing authorities;
 - Banking regulators;
 - Insurance regulators; and
 - Competition and labor authorities.
- Communication to issuers and those responsible for issuer governance;
- Communication to the subject firm, its partners, and employees;
- Communication to the subject firm's global headquarters and international affiliates;
- Communication to other IOSCO members;
- Communication to other major audit firms; and
- Communication to the public and press, both domestic and international.

6.2 Triggering Events and Thresholds Relevant to Communication

Potential triggering events and thresholds that securities regulators might consider in determining whether a particular case should be communicated to other regulators may include:

- Significant regulatory actions (*e.g.* dissolutions of firms, suspensions of operations, etc.);
- Criminal indictments of audit firms;
- Significant judgments or settlements of litigations that may undermine the financial capabilities of the firm; and
- Requirements for major restructuring of audit firms (*e.g.* mergers and acquisitions, spin-offs, separations, etc.) that could affect the availability of audit services

Potential thresholds that securities regulators might consider in determining whether a particular case should be communicated to other regulators may include:

- Possible influence extends to global capital markets;
- Possible influence extends to the group audit of multinational companies;
- Possible influence extends to foreign audits; and
- Possible influence could disrupt a global audit firm network.

Regulators are advised to evaluate direct and indirect effects of triggering events. Not all triggering events may lead to an audit firm crisis. When the effect of an event is judged to create a crisis that extends beyond a country's domestic market, the local securities regulator is advised to initiate communication to other IOSCO members as soon as practicable. IOSCO members

may also wish to consider communicating with foreign auditor oversight bodies and/or the International Forum of Independent Audit Regulators.

An “early warning” system of communications, which could provide sufficient time for other regulators to be prepared, may aid in promoting audit availability and avoiding or minimizing market disruption. In determining necessary communications, securities regulators need to evaluate the nature and magnitude of the crisis and its potential domestic and international effect.

6.3 Content of Communications

The information that a regulator may share will differ according to the facts and circumstances of each crisis and the regulator’s role and authority. Communications may include some or all of the following, depending upon the situation and confidentiality constraints:

- Nature of the crisis, including facts, causes, potential or actual violations, locations involved (in particular, whether the cause or effect is only domestic, cross-border, or an international problem at the network level);
- Regulators’ and other authorities’ likely actions;
- Proposed timeline;
- Potential influence on availability of audit reports in domestic markets;
- Potential influence on availability of audit reports in foreign markets;
- Potential influence on availability of auditors for referral-type work (*i.e.*, unrelated auditors participate in a group audit led by another auditor);
- Potential influence on a global audit firm network (in particular, whether it could result in demise of a global firm network); and
- Person(s) to contact in the originating IOSCO member jurisdiction and contact numbers and email.

7. Follow-up Reviews

During a contingency or crisis, there will be a need to update any previously prepared generic contingency plan and continuously react to events as they unfold. While the pace and urgency of events may put the regulator in reactive mode for a period, to the extent possible, the regulator is advised to consider making contemporaneous notes of issues analyzed and steps taken. At a point following the resolution of the contingency or crisis situation, the regulator may wish to consider conducting a follow-up review of the events, action steps, effects, and consequences. Identifying “lessons learned” can enhance readiness and effectiveness in dealing with future situations.

Illustrative Securities Regulator Contingency Plan Template

The illustrative form or template that follows may be useful to an IOSCO member in guiding the creating of a customized plan for use in the member's jurisdiction.

<p style="text-align: center;">Audit Services Contingency Plan <u>(IOSCO Member Agency Name)</u></p>
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[IOSCO Member]

Contingency Plan updated through Date

Please direct all questions, comments, and information updates to the (Agency) Plan Coordinator(s) listed below

Agency Plan Part I Communications Contacts

Principal agency officials to lead/coordinate contingency or crisis actions and serve as agency spokespersons

Technical and supervisory official(s) authorized to deal with audit firms, issuers, and other government agencies, oversight bodies and legislative bodies

Officials authorized to serve as spokespersons for agency in media relations

Domestic Contacts - Intra-agency, Inter-agency and Others

List appropriate contact information (names, titles, departments, telephone and fax numbers and email addresses) for:

Intra-agency contacts

Auditor oversight authority

Stock exchange

Audit professional and licensing organizations

Audit firm regulatory contacts

Issuers

Other relevant parties in domestic jurisdiction

International Contacts

**IOSCO Secretary General and Secretariat staff in Madrid
(To obtain numbers of relevant regulators)**

Relevant IOSCO members

National and global chief executives of international auditing firms and chief executives of other significant audit firms, and auditor professional bodies, as appropriate

Firm 1

Firm 2

[And so forth]

Agency Plan Part II Potential Contingency or Crisis Indicators and Corresponding Actions

Section A. Potential Indicators

Upon occurrence of any of the following conditions, refer to Part II Section B of this Agency Plan:

- Institution of a criminal proceeding against an audit firm;
- Institution of a major civil proceeding against an audit firm;
- Discovery of a major financial reporting fraud or illegal act at an issuer company;
- Discovery of a material misstatement in financial reporting at an issuer company;
- Discovery of widespread or significant independence violations in an audit firm;
- Discovery of auditor complicity in fraud or other malfeasance in audit firm;
- Whistleblowing or media allegations of improper performance of auditors;
- Announcement of a major restructuring of an audit firm (*e.g.* mergers and acquisitions, spin-offs, separations, etc.) that could affect availability of audit services; and
- Other significant actions or announcements of actions such as potential dissolutions of firms, suspension of operations, criminal indictments of audit firms, major judgments or settlements of litigation of a magnitude that could cause the economic demise of an audit firm.

Section B. Action Steps to Address Contingency or Crisis

1. Gather information and assess likelihood of impact on audit services

Determine nature and likely severity of the potential crisis event, including facts, causes, alleged or actual violations, locations involved (in particular, whether the cause or effect is domestic, cross-border, or international at the network level).

2. Evaluate Effects

Any of the below items or a combination of them may indicate the precipitation of an international crisis requiring the regulatory consideration and actions described in the following sections:

- Possible influence extends to global capital markets;
- Possible influence extends to the group audit of multinational companies;
- Possible influence extends to foreign audits;
- Possible influence could disrupt a global audit firm network;

- Potential negative effect on availability of audit services and reports in domestic market;
- Potential negative effect on availability of audit services and reports in foreign markets;
- Potential negative effect on availability of auditors for assistance in group audits led by another auditor; and
- Potential threat to the financial viability of a major global firm.

3. Consider Alternatives and Potential Consequences

Consider alternatives and decide on appropriate actions to take and their timing:

- Collect information from relevant parties in accordance with Part II Section B 1 of this Agency Plan;
- Review the Reference List (Agency Plan Attachment A) and evaluate which items are applicable to the crisis situation; and
- Evaluate potential consequences of likely action scenarios.

As the crisis unfolds, monitor and analyze market trends and participants' actions following crisis indicators such as the following, and undertake appropriate communications regarding the crisis's effects on the market:

- Behavior of issuers/audit committees who are clients of subject firm; and
- Actions of subject audit firm employees and potential employers at other audit firms.

4. Collect and Disseminate Information

Decide on actions to collect and disseminate information, which may include the following and other actions:

- Consult the Reference List (Agency Plan Attachment A) to determine which items are applicable to proposed communications.
- Develop appropriate messages to be distributed to the persons/entities identified in Part I of this Agency Plan (also see Section 6 of the paper).
- Consider establishing "hotline" numbers for investors, issuers, auditors, broker-dealers, and investment companies to call if they have questions.

5. Follow-Up Review

Update Agency Plan with lessons learned from crisis.

Agency Plan Attachment A

This would be a locally-developed reference list of relevant laws, regulations, standards and policies, including requirements pertaining to types and ranges of penalties, changes of auditors,

predecessor and successor auditors, independence requirements, auditor liability, listing and disclosure requirements, and any past special measures imposed or applied in crisis situations.

Agency Plan Attachment B

This would be a local list of "who audits who" for major listed companies, or directions on obtaining such information.

Agency Plan Attachment C

This would be locally-developed current information on global audit firm international and domestic structure and organization; relevant excerpts from current significant audit firm annual reports.

Other Legal and Regulatory Considerations That May Affect Risks and Effects of an Audit Crisis

This appendix presents ideas that regulators may wish to consider on an ongoing basis, in advance of any crisis or contingency condition, to evaluate whether changes in the current regulation of audit firms and/or modifications in the governance structure of audit firms may have preventive or palliative effects. In addition, guidance or regulation for issuers could have favorable effects that might reduce the likelihood of, or lower the effect of a crisis. Examination of past crises and the considerations set forth in the paper can inform regulators as to which improvements may be preventative and/or ameliorative.

In considering potential improvements, IOSCO members are advised to consider choices for obtaining changes (*e.g.*, introducing proposals for regulation or legislation, recommending best practices, establishing industry goals, influencing audit standards). In the case of regulations or goals for enhanced transparency, consideration should be given to the effects of such transparency and the level and nature of transparency that would be optimal (*e.g.*, reporting to the public or to securities regulators and/or audit oversight authorities only).

Securities regulators may wish to consider the consequences of various kinds of regulatory actions for all market segments and stakeholders (*e.g.*, investors, the capital markets, the domestic and global markets for audit services, global and domestic issuers, as well as the audit firms). Regulators may wish to consider the costs and benefits of potential measures, as well as whether there are prospects for the market to accomplish the same goals absent regulatory action. Notwithstanding these considerations, the following potential actions and outcomes may be within the authority of securities regulators to adopt, recommend or encourage.

Subjects which may be considered for regulatory actions could include:

- Requiring or encouraging transparency of major global audit firms' financial performance and condition, including, with respect to:
 - Liquidity to weather catastrophic financial events, including capital and available credit vehicles, in light of partner draws and other firm outlays and expenses; and
 - Existing contingencies including legal contingencies.
- Requiring or encouraging transparency of major global audit firms' global quality controls systems, including:
 - Audit quality and independence systems;
 - Global firm compliance with standards in all jurisdictions in which the firm operates;
 - Policies for quality controls and for managing engagement risk; and
 - How firms train for, monitor, inspect, verify and enforce compliance with those quality control policies.

- Requiring or encouraging transparency of major global audit firms' personnel practices and policies, including:
 - Restrictions on portability/transferability of partners;
 - Restrictions on portability/transferability of clients; and
 - Restrictions on portability/transferability of retirement plans and other benefits.

- Requiring or encouraging greater transparency of major global audit firms' network structure and governance arrangements, including:
 - General voting arrangements given to firms under networks;
 - Variations of voting rights given to each firm;
 - Veto rights given to particular firms in a network; and
 - Financing arrangements.

- Requiring or encouraging high standards for audit firm governance, including:
 - Establishment of an independent board or governing body;
 - Identification of specific individuals in charge of the firm's quality control practice;
 - Ability to quarantine dysfunctional groups, practices, offices or affiliates within firms; and
 - Measures leading to accountability on a global basis.

- Requiring or encouraging the establishment of other measures for global audit firms and issuers, including:
 - Development of contingency plans; and
 - Liquidity requirements for global audit firms.

A jurisdiction's establishment of an independent auditor oversight authority with inspection and enforcement authority is another form of regulatory action that can address concerns relating to risks and effects of an audit crisis.