

Blog Series: Governance as a Market Advantage
Blog Post no.4

Audit quality and enforcement: foundations of market confidence.

**Written by Jen Sisson (ICGN CEO) and Jakub Brejdak
(Senior Policy Executive) on 6 October 2026**

Audit quality and enforcement: foundations of market confidence.

High-quality audit is a foundational element of the corporate governance ecosystem. Modern securities regulation developed from the recognition that markets cannot function on speculation, selective disclosure and unreliable information. Before the Wall Street Crash of 1929, investors often had limited and inconsistent corporate information, and equity analysis relied heavily on dividends, balance sheet assets or assumptions that recent growth would continue.¹ The collapse that followed exposed the need for stronger reporting obligations, greater valuation discipline and independent assurance over company accounts.

At its simplest level, markets depend on financial statement numbers, and investors do not invest in numbers they cannot trust. Every investment decision rests on confidence that reported financial information is reliable, that material risks have not been hidden, and that the rules designed to protect market integrity are properly enforced.

Although audit may sometimes be perceived as a dull or technical subject, it is core market infrastructure that needs to work well. Investors need confidence that auditing standards are robust, that auditors apply them with independence and professional scepticism, and that audit regulation provides effective oversight.

That confidence is regularly tested by corporate failures, accounting scandals and concerns about auditor independence or audit quality. Trust is hard to build and easy to lose. When it breaks down, the damage goes beyond a single company: it weakens confidence in boards, auditors, regulators and the market itself.

What a trusted audit framework requires

For ICGN, supporting the infrastructure that builds this trust is a key focus area. We see several elements that need to work together:

- We need companies to have appropriate risk management and control frameworks and processes, with strong and effective audit committees overseeing managements reporting and ensuring they appoint the right internal and external auditors.
- We need high-quality audit standards, that are internationally comparable and consistent where possible underpinned by strong ethical and independence standards for auditors.
- We need high-quality auditors doing good work, in line with those standards.
- We need independent, proportionate and robust audit regulation and enforcement.
- We need this system to deliver decision useful reporting for investors.

¹ Edelsten, S. (2026), "A short history of valuing stocks", *Financial Times*, 8 August 2026. <https://www.ft.com/content/5ef8cb99-deae-4c9a-be1f-be791ae6b1cd?shareType=nongift> (09.09.2026).

Looking beyond the cost of audit

The objective should not be overregulation. Audit regulation and high-quality standards create costs, but those costs must be weighed against the benefits of reliable reporting, protecting investor interests and ensuring continued confidence in financial markets. For investors, there is a clear willingness to pay for the assurance that high-quality audit provides. Audit costs are almost always immaterial in the context of a company's overall profit and loss account, particularly when compared with the potential cost of unreliable reporting, weak controls or corporate failure.

This does not mean that money should be spent without discipline. Audit committees, companies and regulators should remain focused on effectiveness and value. Nobody wants too much regulation, but we do need the right amount of regulation to maintain trust and confidence. Investors are prepared to support proportionate expenditure where it is needed to protect the quality and reliability of corporate reporting underpinning the integrity of the market.

Keeping investors at the centre

While companies appoint and pay auditors, investors are the primary users of the audited information. Audit policy, standard-setting and enforcement should therefore be designed with investor needs at their centre. What markets need is a proportionate framework of high-quality standards, independent oversight and credible enforcement. The effectiveness of this framework should ultimately be judged by whether it strengthens the reliability of corporate reporting and supports informed investment decisions. Meaningful investor input into audit policy and standard-setting is therefore essential.

The SOX lesson: audit reform can rebuild confidence

The modern debate on audit quality is informed by the creation of the Sarbanes-Oxley Act (SOX) in the United States. Adopted in 2002 after the collapse of Enron and WorldCom, SOX was a direct response to a loss of trust in corporate reporting, auditor independence and market oversight.² The reforms were significant. SOX created the Public Company Accounting Oversight Board, strengthened audit committee responsibility, tightened auditor independence, introduced executive certification of financial reports and required internal control reporting under Section 404. In doing so, it shifted the audit of US public companies away from professional self-regulation and towards independent public oversight.

The costs of those reforms were also real. Section 404 was particularly controversial because it required companies to document, test and report on internal control over financial reporting, with auditor attestation required for larger issuers. One early survey cited by the SEC estimated average first-year Section 404 compliance costs at USD 4.36 million, with external audit fees increasing by 58%.³

But the evidence also shows why the reform mattered. SOX made weaknesses in companies' financial reporting systems more visible to the market. Research shows that when companies

² Green, S. (2004), "A Look at the Causes, Impact and Future of the Sarbanes-Oxley Act", *Journal of International Business and Law*, 3(1), 33–50.

³ SEC, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements*, 2009.

disclosed problems with their internal controls, investors paid attention and reacted more negatively where the weaknesses appeared more serious.⁴ Other studies found that companies with weak internal controls tended to produce less reliable earnings figures. Importantly, when companies fixed those weaknesses, the quality of their reported earnings improved.⁵

Section 404 also appears to have improved reporting discipline more broadly. Audit Analytics found that the percentage of US accelerated filers reporting restatements fell from 16.1% in 2005 to 13.3% in 2006, after companies had gone through Section 404 compliance cycles.⁶ Iliev's study similarly found that Section 404 encouraged more cautious reporting of earnings and reduced the scope for management discretion in reported profits, although the costs were meaningful, particularly for smaller firms.⁷

In the wake of the Enron and WorldCom scandals, investors clearly wanted and needed better-quality audit, stronger controls and more credible oversight. The SOX reforms and the creation of the PCAOB imposed significant costs, particularly in the early years of internal-control reporting. However, the evidence suggests that those reforms improved reporting quality, brought weaknesses to light earlier and strengthened investor confidence.

The lesson is not that every jurisdiction should replicate SOX in full. Different markets will require different approaches. The more relevant lesson is that weak audit can cost far more than robust audit, and that independent public-interest regulation provides a stronger foundation for market confidence than professional self-regulation alone.

Audit reforms around the world

The SOX experience remains influential, but it is not being copied in a straightforward way across markets. If anything, the current global picture is mixed. Some jurisdictions are strengthening independent audit oversight, while others appear to be slowing, diluting or questioning reform.

The United States itself shows this tension. The PCAOB was created by SOX to move public company audit oversight away from professional self-regulation and towards independent supervision. Yet in 2025, draft legislation in Congress proposed abolishing the PCAOB and transferring its functions to the SEC.⁸ Although the proposal did not become law, it showed that even well-established audit oversight institutions can come under political pressure. This concern is also reflected in recent SEC proposals on filer status, which would raise the Large Accelerated Filer threshold from US\$700 million to US\$2 billion and remove the accelerated filer category. According to the SEC's own analysis, this would mean almost four out of five

⁴ Hammersley, J. S., Myers, L. A. and Shakespeare, C. (2008), "Market Reactions to the Disclosure of Internal Control Weaknesses and to the Characteristics of those Weaknesses under Section 302 of the Sarbanes-Oxley Act of 2002", *Review of Accounting Studies*, 13, 141–165.

⁵ Ashbaugh-Skaife, H., Collins, D. W., Kinney Jr., W. R. and LaFond, R. (2008), "The Effect of SOX Internal Control Deficiencies and Their Remediation on Accrual Quality", *The Accounting Review*, 83(1), 217–250.

⁶ Audit Analytics, 2006 Financial Restatements: A Six Year Comparison, 2007.

⁷ Iliev, P. (2010), "The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices", *Journal of Finance*, 65(3), 1163–1196.

⁸ Lauriello, A. and Berger, M. (2025), "House Financial Services Committee proposes to abolish the PCAOB", Norton Rose Fulbright, May 2025.

https://www.nortonrosefulbright.com/en/knowledge/publications/7ca4af0f/house-financial-services-committee-proposes-to-abolish-the-pcaob?utm_source=chatgpt.com (18.06.2026).

public companies becoming eligible for significantly reduced disclosure requirements, including removal of the Section 404(b) auditor attestation requirement for many companies currently in scope.⁹

In some emerging markets, audit oversight remains more closely linked to the profession itself. In these jurisdictions, key responsibilities such as auditor registration, quality assurance, investigation or discipline may sit largely with professional accountancy bodies rather than a visibly independent public-interest regulator. This can create concerns for investors, particularly where public company audit failures raise questions about whether the system has sufficient independence, resources and enforcement capacity. Professional bodies remain essential to training, technical expertise and ethical standards. But for listed companies and public-interest entities, audit oversight must be demonstrably independent from the profession if it is to command market confidence.

This point is particularly important in markets characterised by concentrated ownership, controlling shareholders or complex related-party structures. In these contexts, outside and minority investors may face greater information asymmetry and have fewer practical levers to challenge management or controlling shareholders directly. Independent audit, strong audit committee oversight and credible enforcement therefore play an important role in giving minority investors confidence that financial reporting has been subject to meaningful scrutiny and that related-party risks or significant judgements have not been obscured.

In other markets, the direction has been more constructive. India, for example, has taken steps to strengthen independent audit regulation through the National Financial Reporting Authority, which is responsible for recommending accounting and auditing standards, monitoring and enforcing compliance, and overseeing the quality of the audit profession. This reflects a broader recognition that credible audit oversight should serve the public interest, not only the profession itself.

Europe is also at an important point. The EU already has a framework for cooperation between national audit oversight bodies through the Committee of European Auditing Oversight Bodies, which was established to support supervisory convergence and the consistent application of EU audit legislation. The Commission is now considering whether this model is sufficient. Recent discussions on EU audit supervision reform have focused on concerns about diverging resources and enforcement practices among Member States, fragmented supervision of cross-border companies, the limited capacity of the CEAOB to drive convergence, and new challenges linked to large audit networks and technology.¹⁰

The UK illustrates the risk of reform fatigue. After the collapse of Carillion, there was strong momentum for audit and corporate governance reform, including replacing the Financial

⁹ SEC, *Enhancement of Emerging Growth Company Accommodations and Simplification of Filer Status for Reporting Companies*, Release Nos. 33-11419; 34-105515; File No. S7-2026-18, 19 May 2026, Economic Analysis.

¹⁰ Accountancy Europe (2025), "EU audit supervision reform: a well-designed approach needed to support capital markets", 15 September 2025. <https://accountancyeurope.eu/news/eu-audit-supervision-reform-a-well-designed-approach-needed-to-support-capital-markets/> (18.06.2026).

Reporting Council with a stronger statutory regulator. But long-promised reforms have been first delayed, then narrowed, and finally completely dropped.¹¹

The uneven pace of national reform makes international cooperation even more important. Companies, investors and audit firm networks operate globally, while audit oversight remains largely national. This creates a risk that audit quality may vary between markets, even where companies are listed internationally or audited by firms within the same global network. Bodies such as IFIAR therefore play an important role by bringing independent audit regulators together to share inspection findings, promote more consistent oversight practices and engage with global audit networks. ICGN is a member of IFIAR's Advisory Group and supports this work, helping to ensure that investor perspectives inform discussions on audit quality, supervision and enforcement.

Enforcement: the missing piece of market confidence

Audit quality cannot be considered in isolation from enforcement. Good rules matter, but they are only credible if they are properly supervised and enforced.

Effective enforcement is not only about sanctions after failure. It also supports better behaviour before problems arise. When boards, management teams and auditors know that reporting obligations are subject to credible oversight, they have stronger incentives to invest in robust systems, controls and disclosure processes.

This is particularly important in periods of regulatory change. As policymakers seek to simplify reporting requirements, reduce perceived burdens and make markets more attractive, they should avoid weakening the safeguards that underpin investor confidence. Simplification can be valuable where it removes duplication or improves usability. But simplification should not mean less reliable information, weaker audit scrutiny or reduced accountability.

Why audit quality matters?

1. Audits reduce the risk of information asymmetry

One of the central functions of audit is to reduce the information gap between companies and outside investors. Management has far more knowledge about the company's financial position, accounting judgements, internal controls and risk exposures than shareholders do. The audit process helps narrow that gap by providing independent scrutiny of the information presented to the market.

Academic evidence supports this point. Teoh and Wong found that companies audited by higher-quality auditors had stronger market responses to reported earnings, suggesting that investors place greater weight on earnings when the audit is viewed as more credible.¹² Other

¹¹ Kissin, E. and Pickard, J. (2026), "Long-awaited audit reform bill scrapped by UK ministers", Financial Times, 20 January 2026.
<https://www.ft.com/content/d16bb7e7-9be7-4b04-b940-058747bb9de2?syn-25a6b1a6=1>
(18.06.2026).

¹² Teoh, S. H. and Wong, T. J. (1993), "Perceived Auditor Quality and the Earnings Response Coefficient", The Accounting Review, 68(2), 346–366.

research shows that investors react negatively to perceived threats to auditor independence, reinforcing the importance of audit credibility to market confidence.¹³

For public markets, this is especially important. Public investors are often outside shareholders with limited access to management and no direct control over day-to-day decision-making. They rely on disclosure, governance and audit to assess whether reported performance can be trusted. High-quality audit therefore supports confidence by making corporate reporting more credible, comparable and useful for investment decision-making.

2. Audit supports effective stewardship

High quality audit also matters because it gives investors a clearer basis for holding boards to account. Investors do not only use audited information to assess company performance; they also use it to evaluate the effectiveness of board oversight, risk management and internal controls.

The audit committee is central to this accountability chain. Investors need to understand how the committee has overseen the audit process, assessed significant judgements, challenged management and protected auditor independence. Clear reporting on audit tendering, auditor tenure, fees, non-audit services and key areas of audit focus gives investors practical “hooks” for engagement. However, investors also need audit committees to explain how they have assessed audit quality and challenged significant judgements in practice, rather than relying only on procedural disclosures about auditor tenure, tendering or fees.

Where disclosure is weak or concerns persist, investors should be prepared to escalate. This may include engagement with the audit committee, questions to the auditor at the AGM, or voting against audit committee members or the reappointment of the auditor. In this way, audit quality supports stewardship by helping investors identify where accountability is working and where it is not.

3. High quality audit lowers the cost of capital

Audit quality is not only a safeguard for investors. It can also create economic value for companies by reducing the uncertainty investors attach to reported information. Where investors have confidence that financial statements have been subject to rigorous, independent scrutiny, they are better able to price risk and may require a lower return for providing capital.

Academic evidence supports this connection. Khurana and Raman found that companies audited by Big Four auditors had a lower ex ante cost of equity capital in jurisdictions where litigation risk increased the credibility value of audit quality.¹⁴ This suggests that investors may reward stronger audit credibility where it gives them greater confidence in financial reporting.

The opposite is also true. Evidence shows that markets react negatively when auditor independence is questioned or when there are serious audit failures. Higgs and Skantz found that higher non-audit fees were associated with weaker market reactions to earnings

¹³ Khurana, I. K. and Raman, K. K. (2006), “Do Investors Care about the Auditor’s Economic Dependence on the Client?”, *Contemporary Accounting Research*, 23(4), 977–1016.

¹⁴ Khurana, I. K. and Raman, K. K. (2004), “Litigation Risk and the Financial Reporting Credibility of Big 4 versus Non-Big 4 Audits: Evidence from Anglo-American Countries”, *The Accounting Review*, 79(2), 473–495.

announcements, suggesting investor concern about auditor independence.¹⁵ Dee, Lulseged and Zhang also found negative stock market reactions where companies were clients of an auditor sanctioned by the PCAOB.¹⁶

For companies, the message is clear. High-quality audit should not be viewed simply as a compliance cost. It is part of the market infrastructure that helps companies earn investor confidence, reduce perceived risk and compete for long-term capital.

The bottom line: investors are the ultimate users of the audit

Audit is a public-interest function. Companies appoint and pay auditors, but investors are the ultimate users of audited accounts and the information they provide. This reality should be reflected more clearly in audit standard-setting, audit committee reporting, supervision and enforcement.

For policymakers and regulators, this leads to four clear and important priorities that should guide future action:

First, remember that investors are the customers of audit and audit regulation. The quality, reliability and decision-usefulness of corporate reporting should remain the central objective of audit standards and enforcement frameworks.

Second, avoid allowing short-term cost savings to overshadow investor protection. Proportionate regulation matters, and unnecessary burden should be avoided. However, cost considerations should be assessed alongside the much greater market consequences of unreliable reporting, weak controls and audit failure.

Third, support greater global alignment of auditing standards and supervisory expectations. Investors increasingly allocate capital across borders, while companies and audit firm networks operate internationally. Greater consistency can support comparability, confidence and more effective oversight.

Fourth, strong independent audit regulators should be the goal. Regulators should be properly resourced, visibly independent from the profession and able to supervise, investigate and enforce effectively. Their approach should be proportionate and improvement-focused, while retaining the authority needed to address serious failures.

Without reliable audit, effective audit committee oversight and credible enforcement, confidence in corporate reporting becomes harder to sustain. That ultimately affects stewardship, capital allocation and the resilience of capital markets.

¹⁵ Higgs, J. L. and Skantz, T. R. (2006), "Audit and Nonaudit Fees and the Market's Reaction to Earnings Announcements", *Auditing: A Journal of Practice & Theory*, 25(1), 1–26.

¹⁶ Dee, C. C., Lulseged, A. and Zhang, T. (2011), "Client Stock Market Reaction to PCAOB Sanctions against a Big 4 Auditor", *Contemporary Accounting Research*, 28(1), 263–291.

CASE STUDIES

Wirecard: when audit failure destroys market confidence¹⁷

Background: Wirecard was once regarded as one of Europe's most successful financial technology companies and was included in Germany's DAX index. However, serious questions had been raised for several years about the reliability of its reported financial position, including concerns around the existence of cash balances, the role of third-party acquiring partners, and the transparency of its revenue and profit generation. The case raised fundamental questions about whether the audit process had applied sufficient professional scepticism, challenged management representations effectively, and obtained reliable evidence over key balance sheet items.

Outcome: In 2020, Wirecard disclosed that €1.9 billion of cash supposedly held in trustee accounts probably did not exist. The company subsequently collapsed, becoming one of Europe's most significant corporate scandals. For investors, the case demonstrated the damage caused when reported numbers cannot be trusted and when warning signs are not properly investigated. It also showed that market confidence depends not only on company disclosure, but on the strength of the audit, supervision and enforcement ecosystem around it.

Carillion: When weak reporting and oversight mask financial fragility¹⁸

Background: Carillion's reporting raised concerns about whether its financial statements gave investors a sufficiently clear view of the company's underlying resilience. The company operated on thin margins, while relying on reporting measures such as net debt and cash conversion that did not fully reveal the scale of its financial fragility. Key issues included a large goodwill balance, a significant pension deficit, the use of reverse factoring arrangements, and limited disclosure on how income from long-term contracts was being recognised. These issues raised serious questions about whether management assumptions had been sufficiently challenged, whether the audit committee had exercised robust oversight, and whether the external audit had applied adequate scepticism to key judgements.

Outcome: Carillion collapsed in 2018 after issuing a series of profit warnings, with significant consequences for employees, pensioners, suppliers, public services and investors. It became a major reference point in debates about audit reform in the UK. For investors, the case underlined the importance of professional scepticism, robust challenge of management assumptions and clear reporting on key accounting judgements. It also demonstrated why enforcement and accountability are essential when reporting failures have wider market and social consequences.

¹⁷ Heese J., Wang C.Y. (2021), *Wirecard: The Downfall of a German Fintech Star*, Harvard Business School.

<https://www.hbs.edu/faculty/Pages/item.aspx?num=59971> (12.06.2026).

¹⁸ Higson C. (2018), *Two lessons from the failure of Carillion*, London Business School. <https://www.london.edu/think/two-lessons-from-the-failure-of-carillion> (12.06.2026).

ICGN is grateful for the support of the Thought Leadership Group composed of Caroline Escott (Railpen), Nana Li (Impax AM), Catherine McCall (CCGG), Ali Saribas (Squarewell Partners), Luiz Martha (IBGC), Simon Rumore (Peakstone Global), Catherine Salmon (ISS), Bob Herr (AllianceBernstein) and Karina Litvack.

We encourage dialogue by contacting Jakub Brejdak, Senior Policy Executive, policy@icgn.org.