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# The PIOB Contribution to IFAC Reform A Self-assessment for the Monitoring Group Review

February 2010

## **Introduction**

### ***IFAC Reform***

Reform of IFAC and the process by which it sets international standards<sup>1</sup> was forged during the early part of this decade at a time when major financial scandals had seriously eroded public trust in the reliability of financial reports and in the usefulness of independent audit opinions. Regulators and other public policy entities called for measures that would effectively address concerns about the audit process and the conduct and competence of audit practitioners. The architects of IFAC reform agreed that the core objectives of the reform were not only to increase the quality of the standards governing these activities, but also to improve the process by which they were formulated and to enhance the focus on ensuring that the public interest is served. The architects of reform believed that these objectives could best be achieved by instilling greater rigor, transparency and accountability into the process by which these standards are formulated. They believed that the standards emerging from this reformed process would result in improvements to the quality of the independent audit as well as contribute to improvements in the competence of audit practitioners. These measures would in turn enhance the quality of financial reporting.

### ***Two Essential Elements of Reform***

The structure emerging from these reforms contained two essential elements:

- first, the continuation of IFAC's responsibility for promulgating standards for auditing and assurance engagements and the education and ethical conduct of accounting professionals, in each case, conditional on

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<sup>1</sup> IFAC sets standards for audit, ethics, education and public sector accounting. The focus of this document is on the standard-setting bodies that were the subject of the 2003 reforms. The reference to IFAC standard-setting bodies for the purposes of this paper is exclusive of the IPSASB except where specific reference is made to that Board.



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substantial reform of the governance, composition and operations of the IFAC standard-setting Boards for these three activities; and

- second, the creation of a new body, independent of the audit profession (the PIOB) to provide the essential element of oversight of the governance and activities of each standard-setting body.

This two-pronged approach enabled the international community to continue to benefit from the commitment of experienced audit professionals to the development of high quality standards that were responsive to the challenges which they and their clients faced in providing effective audit and assurance services. But while the continued commitment of this pool of talent is one of the strengths of this new architecture, it carries with it the potential conflict of having the profession participate in setting its own rules. Thus the second essential element of reform was the management of this potential conflict through the creation of the PIOB, mandated to oversee the standards-setting process to ensure that it would be conducted in the public interest. By requiring approvals by the PIOB before any standard becomes effective, the architects of reform ensured that IFAC would be accountable to an independent body charged with establishing that IFAC fulfills its commitment to promote the public interest in its standards-setting activities.

### ***Our Self-Assessment***

In the report that follows, we will describe how the PIOB endeavours to ensure that the activities of the accountancy profession that are sponsored by IFAC and fall under the PIOB's oversight role continue to serve the public interest as well as the interests of the profession, the regulatory community and other players in the international community who have an interest in the quality of international standards. Our report will comment on the evolving role that the PIOB has played since its inception in helping to fulfill the four objectives of IFAC reform outlined in the Monitoring Group guidance for self-assessment. These four objectives are:

- an externally validated process for monitoring and oversight of IFAC's standard-setting and compliance regimes;
- increased transparency with respect to IFAC governance and its international standard-setting activities;
- a broad-based external participation in IFAC standard-setting activities; and



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- a more collaborative and comprehensive international process for determining how accountants and auditors can best contribute to the integrity of the international financial system.

As well as the PIOB's role in helping fulfill these four objectives of IFAC reform, its performance could also be benchmarked against the provisions envisaged in the 2003 IFAC Reform Proposal: today the PIOB has a small staff of dedicated professionals, it is a lean and effective organization headquartered in Madrid, and the Board meets regularly four times a year.

Our report will also review the current projects (post the Clarity Project and revision of the Code of Ethics for Professional Accountants) in which IFAC is engaged as well as the actions and recommendations for future activities set out in a preliminary draft of IFAC's response to the Monitoring Group's request for self-assessment. Our report will conclude with our analysis of what lies ahead. This "looking forward" section will include our assessment of the continuing need for PIOB oversight of these current and anticipated future standard-setting and compliance activities of the PIACs plus our recommendations for structural improvements and enhancements to the efficiency and effectiveness of the current architecture.

### **Role of the PIOB**

The PIOB was established to oversee IFACs standard setting in the areas of audit standards, education and ethical standards for professional accountants, including independence for auditors, quality control and assurance standards, and IFACs Compliance Program.

The PIOB's oversight responsibility extends specifically to three of IFAC's independent standard-setting bodies and their respective Consultative Advisory Groups (CAGs):

- the International Auditing and Assurance Standards Board (IAASB);
- the International Ethics Standards Board for Accountants (IESBA); and
- the International Accounting Education Standards Board (IAESB).

The PIOB also oversees the Compliance Advisory Panel (CAP) of IFAC, which evaluates member body compliance with IFAC membership rules, including each member's progress in promoting the adoption of private and public sector accounting (IFRS and IPSAS), audit, ethics and education standards. These



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independent standard setting bodies and the CAP are collectively referred to as “public interest activity committees” (PIACs).



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## **PIOB's Oversight Model**

In assessing whether the public interest is being served, by its oversight, the PIOB attempts to answer three simple questions:

- Are the PIACs' processes the right processes?
- Are the right people implementing these processes?
- Are the processes being implemented properly?

The PIOB carries out its oversight responsibilities through:

- direct and comprehensive observation of PIACs and CAGs;
- oversight of the process for nominating PIAC members;
- intensive interaction with IFAC leadership;
- reports from and dialogue with PIAC and CAG chairs; and
- the PIOB's own independent staff reviews.

Our goal is to ensure that there is accountability, transparency and responsiveness to stakeholder needs throughout the entire process. Our approach is to examine each aspect of the standard setting activities to ensure a rigorous focus on the public interest in the manner described below:

### ***Strategies, Policies and Procedures – the “Right Processes”***

The PIOB examines the quality, transparency and public interest focus of two key processes – standard-setting boards' strategic planning and priority setting, and PIAC standard-setting activities and interaction with the CAG. The PIOB considers it important to evaluate each of these processes to determine whether due process has been designed in a way that is responsive to the public interest.

In the second year of its operation, the PIOB requested the development of a common framework for use in strategic planning. The framework was subsequently applied by all three independent standard-setting boards in the development of strategic plans. These plans were approved by the PIOB as satisfying due process requirements and being complete from a public interest perspective. A similar role is played in regard to PIAC Terms of Reference, and key policies and procedures. For example, in its first year of operation, the PIOB encouraged a new IFAC statement of Due Process and Working Procedures,



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which it then proceeded to review and approve. The due process approved by the PIOB contained five main elements:

- consistency and high quality across the three standard-setting boards;
- a high level of transparency;
- explicit recognition of the PIOB's role;
- open consultation during the "exposure period" for new standards; and
- PIOB satisfaction that the process applied to the development of a new standard fully complies with the approved process.

Earlier this year the PIOB reviewed a draft of IFAC's first triennial review of these procedures and requested a number of changes to fully clarify the role of the PIOB. The PIOB also provided additional observations which have been considered by IFAC and reported back to the PIOB by the end of 2009.

### ***Nominations – the "Right People"***

The PIOB oversees the process for populating the PIACs with members, Chairs and Deputy-Chairs, which includes the process for seeking nominations as well as the actual selection of nominees presented to the IFAC Board. The PIOB closely monitors the nominations process through direct observation of all meetings of the IFAC Nominating Committee and regular consultations with IFAC leadership on nominations issues. The PIOB is also asked to review and consent to the appointment of new CAG member organizations to help ensure that such appointments will further diversify the CAGs' membership and improve their contribution to the standard-setting process.

The PIAC governance structure and rotational policy have been formulated following recommendations by the PIOB to address several (sometimes competing) objectives, all of which are in the public interest:

- to ensure that each group is comprised of individuals with a broad variety of regional, professional and other perspectives;
- to maintain an appropriate balance in all respects, in particular the requirement for parity between practitioners and non-practitioners;
- to balance the need to introduce fresh viewpoints and experience on a regular basis against the need to maintain essential continuity, especially at the leadership level; and



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- to require the appointment of public members and to enlarge the pool from which they are drawn.

Additionally, following the PIOB's request, the Forum of Firms now proposes multiple nominations to fill each of the positions allocated to them in the standard-setting boards. This has significantly increased transparency and has provided the Nominating Committee with greater flexibility to achieve diversity objectives.

In reaching its conclusions on appointments, the PIOB first considers the transparency, inclusiveness, public interest focus and overall quality of due process used in recruiting and selecting final candidates. It then considers the balance and impact that proposed new appointments would have on the composition of each PIAC and on the PIAC's effectiveness in reaching its goals.

Since its inception members of the PIOB have attended 28 meetings of the Nominating Committee and the PIOB has followed the development of nomination slates, deliberated and finally approved approximately 100 nominations to the PIACs. In addition the PIOB has approved all new CAG member organizations.

### ***Standard-Setting – “Proper Implementation”***

Standard setters are given final authorization to publish each finished standard only after:

- the PIOB has determined that all due process steps have been followed effectively and with proper regard for the public interest;
- obtaining assurance from the CAGs that issues they raised have been considered; and
- conducting the PIOB's own due process review.

In applying its oversight model, the PIOB closely supervises the ongoing process of deliberation, consultation and finalization used in the development of each and every standard. Two years ago the PIOB requested that independent standard-setting boards provide quarterly reports for each standard under development on the status of the due process steps. Each standard presented for PIOB approval prior to final publication must be accompanied by an individual evaluation of due process completion prepared by IFAC's Executive Director, Professional Standards.



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Three substantive features of this process pertain directly to the achievement of public interest objectives and therefore require the PIOB's close and ongoing attention. The first of these is the PIOB's determination that CAG comments are being adequately considered. Given the diversity of membership of the CAGs and the independence of their member representatives from the profession, the PIOB considers the views expressed during CAG deliberations to be a key indicator of the public interest. The PIOB considers whether all significant issues confronting the standard-setting boards are raised with the CAGs. At the PIOB's request, the independent standard-setting boards now report back to the CAGs on the disposition of CAG comments. The PIOB has also requested that the CAG chairs provide assurance that the CAG is satisfied that its comments have been appropriately considered by the PIAC.

The second substantive feature of this process is a determination that comments coming from stakeholders who represent a strong public interest perspective are being considered in a comprehensive and responsive fashion.

Finally, the PIOB examines whether the independent standard-setting boards publicly describe how they have dealt with the comments received and, where a board does not adopt material changes recommended by commentators, it explains its reasoning. This is addressed in the "Basis for Conclusions", a public document identified by the PIOB as being a critical indicator of whether the public interest has been fully considered and dealt with in an appropriate manner. At the recommendation of the PIOB this document has become more comprehensive and is now prepared for each standard.

Since its inception, members of the PIOB have observed 83 meetings of the PIACs and their respective CAGs; also, the PIOB has determined that due process has been effectively followed and with proper regard to the public interest for 51 standards, including: "closed-off" forms of standards; all of the Clarity project ISAs; 1 International Standard on Quality Control; 1 International Education Standard; 3 International Education Practice Statements; and the redrafted Code of Ethics for Professional Accountants which included separate projects on revisions to sections 290 and 291 of the Code which deal with "Network Firms" and "Independence".

### **Effectiveness and Responsiveness of the Oversight Model to the Public Interest**

We offer the following observations on the attributes of the oversight model that the PIOB has developed and pursued since its inception.



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- Direct observation of PIAC and CAG activities enables the PIOB to understand the dynamics of standard-setting work and to evaluate the quality and effectiveness of deliberations. PIOB members personally observe all PIAC and CAG meetings. First-hand opinions are formed on the overall level of professionalism, efficiency, transparency, inclusiveness and public interest focus of each PIAC and CAG. These opinions, along with other inputs, contribute to the formulation of the PIOB's final view on the appropriateness of each stage of the process used to develop individual standards.
- Direct and comprehensive monitoring also enables timely PIOB intervention when public interest concerns arise and ensures that the final assessment of each completed standard will reflect and incorporate the observations and conclusions of PIOB members on transparency and fairness accumulated during the standard's development.
- First-hand observations are supplemented with reports from and dialogue with PIAC and CAG Chairs. The PIOB also meets regularly with IFAC leadership on nominations and other public interest activities undertaken by the IFAC Board. The PIOB Chairman normally attends IFAC Board meetings, while discussions with IFAC leadership are a regular agenda item at PIOB quarterly meetings. Discussions cover items brought to PIOB by IFAC for consideration as well as matters raised by PIOB.
- Our continuous presence at all IAASB and IESBA meetings during the final phases of the Clarity and redrafted IFAC Code of Ethics projects enabled us to assess how well these groups maintained focus on the public interest while also dealing with an extraordinarily large workload. Based on close observation we were positioned to provide concrete views to the PIACs and CAGs and, in some cases, recommendations on various public interest matters.
- Exchanges with the IFAC leadership provide PIOB with valuable insights into key developments and initiatives having an impact on the general public interest environment prevailing within IFAC and on the progress of nominations and the development of related policies. Discussions with Chairs of the PIACs and CAGs provide similar insights into specific projects and the overall conduct of their activities.



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- Work conducted by PIOB staff under the Extended Review Framework (ERF) provides additional independent assessments of the due process applied to the development of individual standards and standard-setting boards' strategic plans. Through ERF procedures the PIOB takes a closer look at the effectiveness of the various steps completed during the life cycle of selected projects, especially the period between the commencement of the public consultation process and finalization of the standard. The ERF is applied only to certain standards selected by the PIOB on the basis of public interest priorities. Extended reviews have identified more generic due process and public interest related issues that can be communicated to IFAC for corrective action. The PIOB focuses on due process quality and does not take a view on the technical substance of individual standards. Nevertheless, the PIOB intervenes on both counts whenever it believes the public interest is at risk.
- The PIOB focuses on achieving an appropriate balance among various perspectives so that the views and concerns of all constituencies are heard and incorporated into final solutions where appropriate.
- In assessing the completeness of due process, the PIOB focuses on the integrity of processes used to aggregate, assess and reflect public comments. This includes the quality and completeness of deliberations and the quality and transparency of public accountability reports to CAGs and other interested external parties.
- The PIOB maintains ongoing contact with international and national regulators and other entities with an interest in enhancing audit quality and increasing public confidence in financial reporting. These interactions with interested external parties are a source of continuing public interest perspectives and priorities that help to maintain a well-balanced and independent view, and as such are a very useful complement to existing consultation processes.

### **New Rigour in the Process**

A comparison of the processes, procedures, and relationships that existed at the time of the PIOB's establishment with the significantly more robust situation today provides confirmation of the validity of the PIOB's oversight model.



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### ***The PIACs***

Standard setting boards in early 2005 already operated under prescribed due processes and operating procedures including various consultation elements. However, individual board practices differed, some board structures were more heavily weighted toward practitioners than others, diversity needed more attention, strategic planning processes were opaque, and none of the boards was subject to independent public interest oversight.

Today, all three independent standard-setting boards apply rigorous and consistent processes and operating procedures designed to serve the public interest. Both standard setting and strategic planning are conducted in a highly transparent and inclusive manner. Final board decisions are documented and explained through new or improved public accountability documents. Further, the balance and diversity of perspectives on each PIAC has been improved through achieving parity between practitioners and non-practitioners and measurable progress toward other diversity goals. Furthermore, the inclusion of three permanent observers to the IAASB and IESBA (PCAOB, European Commission and Japanese FSA), with rights of the floor, has helped to broaden the scope of their deliberations. Finally, PIAC due process is continuously monitored by the PIOB.

Compliance by IFAC members with their Membership Obligations has made significant progress under the vigorous leadership of the Compliance Advisory Panel (CAP). Membership Obligations include, on a best endeavours basis, adopting and supporting implementation of standards developed by the PIACs and the IASB, as well as quality assurance and investigation and disciplinary regimes. In addition, action plans designed to ensure and enhance compliance with Membership Obligations are being developed by IFAC member bodies under the guidance of the CAP and are progressing, or have progressed, to the stage of implementation. Many member bodies have adopted and are executing their action plans. We believe that the compliance program has become, and will continue to be an important platform for encouraging and facilitating adoption and implementation of international standards.

### ***The CAGs***

In 2005, only the IAASB CAG was led by an independent Chairman. The IAASB CAG Chair was first appointed in September 2004. All three groups met in private and discussed agendas set primarily by the standard-setting boards. CAGs were



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an acknowledged source of external stakeholder views and advice on project content. However, their overall influence on the quality and outcomes of due process was difficult to assess in the absence of formal accountability mechanisms and independent oversight.

Today's CAGs are all independently led, set their own agendas and meet in public. The Chairs of the CAGs attend PIAC meetings and regularly exercise their rights of the floor. Each CAG has developed effective mechanisms to measure its board's responsiveness to CAG member input. Finally, these groups are subject to continuous PIOB oversight.

The comments and views of the CAGs constitute a critical and highly valued input to the standard-setting boards, and the CAGs' diverse membership ensures that an adequate number of varied and responsible stakeholders participate in CAG deliberations and thus influence standards developed by the PIACs.

### ***Nominations***

In 2005, the IFAC Nominating Committee's board and committee selection process included a public call for candidates and the application of various technical and other criteria to select final nominees. However, there was no independent approval of final nominations to PIACs, PIAC member performance was not subject to formal evaluation, and nominations due process was not subject to formal public oversight.

Today, all board and committee candidates, not just those standing for appointment to PIACs, are recruited and selected using significantly enhanced criteria and procedures that incorporate recommendations made by the PIOB. More comprehensive, targeted and transparent annual calls for nominations have dramatically increased the volume and diversity of well-qualified candidates for practitioner, non-practitioner and public member vacancies. The annual Call for Nominations now explicitly emphasizes the role of the public interest in the nominations process and commitment to the public interest has been explicitly identified as a component in IFAC's recently implemented performance evaluation program. All aspects of the IFAC nominations due process are overseen by the PIOB, which also gives final approval of all PIAC appointments.

The requirement for parity between practitioners and non-practitioners, including designated public members, ensures that the view point of audit professionals is matched by a broad spectrum of other professionals' perspectives, including



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academic and government experts. Furthermore, parity strengthens the boards' independence and enhances their external credibility; additional diversity in the form of better geographic and gender balance has also been achieved.

### **PIOB Independence**

The PIOB is at arm's length from the activities that it oversees.

- PIOB members are appointed by the Monitoring Group for three-year terms;
- Independence of mind guides the evaluations of what the PIOB observes in the oversight process;
- PIOB members do not specialize in particular standard-setting Boards or CAGs; and
- PIOB Members draw on their own independent staff resources to assess the rigour and quality of due process.

In the past, concerns have been expressed that the provision by IFAC of a significant portion of the PIOB's funding either compromised its independence or created the perception of a lack of independence. These concerns ignore the fact the PIOB has received considerable funding in kind from the Spanish Government, the Basel Committee and the World Bank. The PIOB believes that its current sources of funding have not compromised its independence:

- IFAC has provided an unconditional commitment to the Monitoring Group to provide guaranteed funding for the operation of the PIOB, initially for five years, and has subsequently renewed its commitment for a further period ending in 2015; the absence of conditionality on this funding eliminates the risk of a conflict of interest;
- The Monitoring Group is responsible for sourcing the PIOB's funding and for the approval of its annual budget; the PIOB is thus completely removed from discussions of its funding with IFAC; and
- The European Commission has agreed to contribute a significant proportion of the PIOB's funding.

The PIOB supports the continuing efforts of the Monitoring Group to further diversify the sources of PIOB funding as diversification of its funding will further strengthen its independence.



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### **Fourth Objective of the IFAC Reform**

The preceding discussion demonstrates that the PIOB has been responsive to the first three of the four objectives of IFAC reform:

- to ensure an externally validated process for monitoring and oversight of IFAC's standard-setting and compliance regimes;
- increased transparency with respect to IFAC governance and its international standard-setting activities; and
- broad-based external participation in IFAC standard-setting activities.

The fourth objective of IFAC reform states:

- a more collaborative and comprehensive international process for determining how accountants and auditors can best contribute to the integrity of the international financial system.

We believe that the system of independent oversight and monitoring by the PIOB has contributed positively to the achievement of this fourth objective of reform. High quality global standards developed on a collaborative basis with a clear focus on the public interest are a prerequisite for adoption by national jurisdictions and for global adoption and implementation of international standards. The PIOB's oversight of the processes by which standards have been formulated provides valuable assurance as to the quality of those standards. This collaborative and comprehensive process for developing standards could serve as a model for other types of collaboration in the financial arena. Adoption and implementation of an agreed set of credible international standards will provide a basis for the development of consistent and comparable audited financial statements and thus support the stability of the international financial system.

### **Looking Forward – Improving the Architecture**

Although we believe that much progress has been made in achieving the original objectives of IFAC reform, we also believe that this self-assessment process provides a timely opportunity to make changes to the existing architecture to better prepare all participants in the reform to meet anticipated future challenges. The PIOB is well positioned to contribute to this process.



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A key element in the PIOB's approach to its mandate has been the maintenance of dialogue with other important actors in the international financial system. The PIOB engages in dialogue with members of the Monitoring Group (the International Organization of Securities Commissions, the Basel Committee on Banking Supervision, the European Commission, the International Association of Insurance Supervisors, the World Bank and the Financial Stability Board), IFAC, its member bodies and regional accounting professional bodies, as well as with national audit regulators and IFIAR. This ongoing communication has enabled the PIOB to remain informed about existing activities designed to deliver improved financial reporting, as well as evolving public interest priorities and concerns. For instance, discussions with the European Commission were conducted in the context of the possible adoption of ISAs in the EU that have proved very fruitful. By these activities the PIOB has also facilitated a dialogue and communication between the bodies that it oversees and other relevant organizations outside IFAC. Notable examples are communication between IAASB and the CAP with IFIAR, the latter of which followed an explicit recommendation by the PIOB, and the ongoing development of links between IAASB and IASB. These links can lead to improvements both for accounting standards and the standards of audit, and could usefully be extended to the Ethics and Education standard-setting boards.

Further, the PIOB has accumulated knowledge and expertise of the processes by which standards are developed, adopted and implemented which it regularly shares with governments, regulators, the accountancy profession and members of the public.

In the remaining sections of this report, we draw on the knowledge and expertise obtained during our first five years to propose structural and operational changes to the existing system of formulating, adopting and implementing auditing, educational and ethical standards for the profession.

## **1. Structural Improvements<sup>2</sup>**

The existing structure was born out of the need for reform. It has worked successfully to facilitate and implement the reform process. However, now that this process has been accomplished, the need is for a new long term stable structure.

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<sup>2</sup> The PIOB Board has reached full consensus on this section ("1. Structural improvements") with the exception of one member, Mme Sylvie Mathérat, who has expressed "dissident views on the suggested structural improvements since I believe that the current nominating and monitoring procedures meet the objectives of the IFAC reform in a satisfactory manner".



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The basic components of the current architecture are appropriate: the standard setting boards are independent of the profession; the Boards are made up of 50% practitioners and 50% others, which can be either public members or other non-practitioners; the CAGs have been reinforced both in composition and process; the compliance program is encouraging global adoption and implementation; the PIOB applies independent oversight over the observance of due process in standard setting as well as on the selection of members of the PIACs, both with a specific focus on the public interest; and the PIOB is monitored by a group of publicly-accountable organizations.

Looking forward, we do not recommend structural changes in the area of PIACs (standard setting Boards). Following measures taken by IFAC and recommended by the PIOB, they are now generally globally representative bodies.

In order to ensure a long term stable architecture, however, we believe that structural changes should be made to the relationship between the PIOB and the Monitoring Group, the composition and selection of the PIOB, and the composition and role of the Monitoring Group. Below, in the section entitled "PIOB Future Directions" we also propose changes to the structure and operating procedures of the CAP.

### ***Composition of the PIOB***

The PIOB should be globally representative. It should reflect the nature of PIACs in order to reflect the nature of its responsibilities over them. The composition of the PIOB should be made up of 11 members representing all the regions of the world. The Chair and Deputy Chair would be selected from amongst the 11 members by the MG in consultation with the PIOB. Selection of PIOB Members should be subject to final approval by the MG. The selection process would be carried out by a selection committee of the PIOB, following a due process agreed with the MG and operating transparently under a public call for nominations and clear selection criteria. Terms of appointment should be staggered to provide continuity, and generally three years with possible reappointment to a second term.

### ***Composition and Role of the Monitoring Group***

The respective roles and responsibilities of the Monitoring Group and the PIOB should be set out in an expanded Charter, which should incorporate agreed due



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process of the Monitoring Group in dealing with the PIOB. This Charter should be drafted jointly by the MG and PIOB in consultation with IFAC. The draft should be publicly exposed and adopted by mutual agreement of the PIOB and the MG. The Charter should undergo a public review every five years, carried out jointly by the PIOB and MG.

We fully support the need for the work of the PIOB to be monitored by a publicly-accountable organization. Ideally, such an organization should have the legitimacy of itself being accountable to elected representatives from a globally diverse group of countries. The Monitoring Group was created in 2002 to bring together influential policy-makers, who individually are publically accountable organizations, committed to ensuring that the future processes for creating and implementing international standards for auditing would serve the public interest. As we have observed earlier in this report, the reforms overseen by the MG have fulfilled this original objective. Looking forward and given the challenges that we will face, the Monitoring Group should be improved to acquire greater seniority, a stronger global reach, broader legitimacy of accountability, a more formal structure and be subject to agreed due process. Alternatively one possible model with these attributes could be the Financial Stability Board, which has all of these characteristics: formal structure, seniority of representation, created by governments, global reach, and public accountability to governments. Importantly, it also has a secretariat with the resources and ability to carry out its responsibilities.

The responsibilities of this monitoring body should be to: monitor that the PIOB carries out its responsibilities; ensure that the PIOB has the necessary diversified financial resources; give final approval of PIOB members, Chair and deputy Chair; review annually the PIOB budget; raise any matters of mutual interest that affect the operations of the PIOB; meet at least twice annually, or more often if appropriate, with the PIOB.

## **2. Improving the Efficiency and Effectiveness of the Current Architecture**

Efficiency and effectiveness can be improved.

The standard setting process needs more investor representation. More use of experts should be used in boards, task forces and standard setting work, and their roles should be clearly defined. The role of technical advisors should be limited to



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technical matters and communications should go through the member. Compensation of PIAC and CAG chairs should also be considered.

Communication of the reform process in order to increase investor confidence must be improved. To date, neither IFAC has had the independence nor the MG the resources to carry out an effective communication policy. Therefore PIOB communications policy must be further developed in line with its mandate. This communications policy should aim to increase investor confidence by increasing the understanding of the processes of standard setting, demonstrating independent oversight from the profession and highlighting recommendations to IFAC. Improvements in communications are imperative to further the already positive perception that appears to exist about the standard setting processes and compliance activities overseen by the PIOB. Discussions with key stakeholders should be documented and published, where appropriate.

The Forum of Firms (FoF) brings together 21 firms that perform transnational audits and are involved with IFAC's activities in the areas of audit and assurance services. The Forum allows for exchanging the international expertise and perspectives of their member firms and promotes adoption and implementation of international standards. The FoF nominates five members to each of the IAASB, the IAESB and the IESBA to contribute to the standard-setting process. The PIOB is aware of the relevant role played by the Forum of Firms, and believes that it should communicate with the Forum on a regular basis so that there is an ongoing dialogue between the PIOB and the Forum on such matters as their nominations to PIACs and how the CAP coordinates with the Forum to move forward the implementation of the standards.

In a similar vein, IFAC's Small and Medium Practices (SMP) Committee represents the interests of professional accountants operating in small and medium sized practices, usually providing accounting and assurance services to small and medium sized enterprises (SMEs). These two groups are expected to face special challenges with the implementation of international standards. SMP Committee works with PIACs and other standard-setting bodies and issues professional guidance and research documents on topics of interest, so the PIOB should also communicate with the SMP on a regular basis.

The PIOB finds that the "best endeavours" formula used in the current SMOs may no longer be optimum language to set obligations for IFAC member bodies. The PIOB is aware of and highly supports the current CAP initiative to revise all SMOs and strongly encourages the CAP to proceed in this direction.



Public Interest Oversight Board

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Further, the PIOB recommends that IFAC member bodies' accountability should be strengthened by requiring IFAC member bodies to report on the progress made on implementation by their own members, asking IFAC member bodies to create an infrastructure to support implementation (e.g.: education programs) and to set a code of conduct or corrective actions for their own membership.

### **3. PIOB Future Directions**

The PIOB intends to continue to focus on the primary tasks laid out for it under the IFAC reform and on the objective of high quality standard setting for international use. In our work to date the core public interest focus has been on standard setting and due process in standard setting. Although, with the completion of the Clarity Project and the publication of the Code of Ethics, we expect the pace of standard setting to diminish, the work plans of all three standard-setting boards include proposals to review and revise existing standards. In particular, the strategic plan developed by the Education Standards Board (IAESB) describes an ambitious cycle of revision of the eight extant education standards and the IAASB has begun the development of some new standards. With respect to these activities, the PIOB expects to continue the oversight model that has been discussed earlier in this report.

As IFAC, the standard setting boards and the CAP formulate their future work plans, broader issues relating to the public interest become apparent. For example, mechanisms are being developed for reviewing the effectiveness of standards and for making urgent additions to authoritative pronouncements. In addition, processes are being considered for rapid response to urgent issues and the CAP is considering whether the Statements of Membership Obligations should be supplemented. The remainder of this section highlights some of these areas and identifies how the PIOB could contribute to fulfilling the new objectives

#### ***The Expanding Scope of Audits***

The scope of audits is expanding, and so too is the scope of areas covered by standards setting. Several of the projects on which the IAASB has embarked respond to requirements beyond what is strictly understood today as a financial audit. For example, the IAASB's project to create a framework for reporting on greenhouse gas emissions breaks new ground for the profession. Decisions made in the development of this framework will undoubtedly create precedents for the profession's response to demands for assurance services in other areas such as sustainability, corporate social responsibility and environmental consciousness.



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The frameworks developed will affect not only the future economics of the profession and the business models of the firms of professional accountants, but also the public's need and desire for accountability and reliability in all forms of corporate reporting.

The IAASB has also undertaken projects to refine the standards for review and compilation engagements. These efforts, and others, may, among other things, assist small and medium sized preparers to provide a level of assurance beneficial to the users of their financial statements without incurring the cost of a full audit. One consequence of these developments is a widening of the range of stakeholders, which challenges the traditional "user, preparer, regulator" approach to representing the public interest. As these new projects proceed, the PIOB, in consultation with IFAC, the PIACs and the Monitoring Group, will need to be satisfied that public interest representation has been sufficiently inclusive to engage those who have a stake in the outcome.

### ***Education Standards***

Education standard setting is different from that for auditing standards in at least three respects. First, it is less prescriptive in nature; the objective is to ensure that proper education practices are followed for aspiring and established accountants. Second, the stakeholders in education standards go beyond IFAC members to include universities and other experts involved in the education of professional accountants. Third, the implementation of education standards is more sensitive to the level of development in the country or region in which they are to be applied.

These differences raise a number of questions that may be unique to the setting of education standards. For example, would the objectives of ensuring that proper education practices are followed be best achieved through principles, standards or guidelines? Who should be considered in the range of stakeholders? Should the current approach of IFAC to developing countries be modified and, if so, how? There are clear public interest implications to the answers to these questions and the PIOB will continue to work with the IAESB and its CAG in addressing these issues.

The IAESB strategic plan includes an ambitious cycle of revision of the eight extant education standards. Given the scope of this program and the important issues referred to above, the PIOB has expressed a concern that the Education CAG may be too small to be able to provide the necessary advice and support.



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We have recommended that the CAG should consider adding organizations and individuals to its membership with relevant diversity, expertise and perspective.

### ***PIOB Oversight of Adoption and Implementation***

Adoption of international standards in the areas of audit practice, assurance services, ethics and education for professional accountants by many jurisdictions around the world will bring new requirements and challenges to the forefront. Implementation will challenge and increase the workload of international standard setters in many ways, including requests for interpretation, practice guidance, revision of existing standards and, potentially, the creation of new ones. With more than four years of experience in monitoring and overseeing IFAC's responses to the challenges it faces, the PIOB is ideally positioned to ensure that a proper public interest perspective is maintained in these potentially important new areas.

The proper implementation of standards is a joint responsibility of audit practitioners, other accounting professionals, accounting bodies and national audit regulators who are charged with ensuring compliance. Implementation involves numerous activities and actors to help set the stage for successful compliance. Some of these tasks and processes include standards translation, the adoption of standards by national jurisdictions, the development of implementation methodologies by all sizes of audit practice, practitioner education and training, development of professional bodies in emerging markets or regions, and the creation of mechanisms and communications channels to promote achievement of uniform implementation practice outcomes around the world. While these are largely national activities, the creation of necessary conditions to support compliance success is an area of implementation support that requires international coordination subject to common due process disciplines. Implementation and compliance must be effective to serve the public interest. The PIOB role will be to provide transparency, identify gaps and overlaps, identify challenges, coordinate disparate efforts and assess effectiveness.

This is a large area and a number of activities are already being carried out. For example, the International Forum of Independent Audit Regulators (IFIAR) is playing an important and growing role in identifying the processes used by audit firms to implement international standards and evaluating how these standards are being applied in practice. The PIOB has established a strong dialogue with IFIAR.



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The World Bank plays a broader and more macro role in determining whether countries are complying with adopted standards, through its Reports on the Observance of Standards and Codes (ROSC) initiative.

Finally, the work of the CAP is growing rapidly in importance. The IFAC Compliance Program to test and promote improvement in IFAC member bodies' compliance with their obligations relative to international standards is a platform to promote and achieve adoption and effective implementation of these same standards. The advice and direction provided by the CAP is crucial to the success of these initiatives. The CAP is already subject to intense PIOB oversight. Going forward it would be beneficial to evaluate whether the Public Interest dimension of the CAP's work would be strengthened through adoption of certain of the principles and practices underlying the work of the standard setting boards. An immediate step could be for the CAP to review its current Terms of Reference as well as to consider developing its own Due Process and Working Procedures document.

### ***PIOB Oversight of Public Sector Accounting Standards***

International Public Sector Accounting Standards (IPSAS) are produced by a body which functions under the auspices of IFAC but does not come under PIOB oversight. In this case, the standards development model is not analogous to that of the other IFAC bodies nor of the IASB, principally because the preparers and regulators are largely part of the same governmental organization.

IFAC is currently proposing that the PIOB's mandate should be extended to cover IPSAS. Accounting standards for the public sector are undoubtedly acquiring increasing importance in the post-crisis world economy after the fiscal expansion that is taking place. We believe that the setting of public sector accounting standards would benefit from public interest oversight and that the PIOB could, in principle, conduct that oversight. Oversight of IPSASB would provide full coverage of all public interest activities of IFAC. There are however significant areas of conceptual and practical clarification that need to be addressed before such oversight is considered. The definition of "public interest", the determination of stakeholders who represent the public interest, and the clarification of the meaning of independence in standard setting are important issues that must be clarified, as the existing structure for standard-setting oversight cannot be directly applied to the case of IPSAS.



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## **Concluding Remarks**

The architects of IFAC reform sought to increase the quality of the standards governing the audit process and the competence of audit practitioners. They recognized that to achieve these objectives there needed to be improvements in the process by which the standards were formulated and an increased focus on serving the public interest. The existing structure was born out of the need for reform. It has worked successfully to facilitate and implement the reform process. We believe that the reforms implemented since 2005 have produced substantial improvements in the governance of IFAC and its standard-setting bodies and in the process by which standards are set and implemented. The public interest is taken into account in all stages of standards development. Moreover, the process of standards development is sufficiently transparent and independent from the accountancy profession to ensure that fairness and the public interest is served

We also believe that these improvements have been achieved through the development and refinement of two of the essential elements of reform: the continuation of IFAC's responsibility for assembling teams of highly qualified professionals to develop auditing, education and ethics standards- and the management of the potential conflict between professional and public interests through the oversight of the PIOB.

Thus the goals of the original IFAC Reform have been largely accomplished. Further reforms are needed, however, to adapt the current architecture to the challenges of the future. This self-assessment outlines structural changes and improvements to efficiency and effectiveness that will further strengthen the process for setting, adopting and implementing international standards.