



## “International Standard Setting: The Governance Challenge”. Berlin’s IFAC Council.

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Good morning, ladies and gentlemen. It is my pleasure to be here with you today in Berlin on the occasion of the IFAC Council’s meeting. I would first like to thank the organizers, in particular the IFAC Chairman, Göran Tidström, its Executive Director, Ian Ball and their team, for giving me a unique opportunity to address such a distinguished global representation of accountants and auditors.

I understand I have been invited to participate in this forum in my double role of member of the Monitoring Board –representing IOSCO- of the IFRS Foundation and, especially, as Chairman of the Monitoring Group of the –so called- IFAC structure. I am happy to do so, though I should appeal to your indulgence to allow an economist to deal with issues which are not part of his educational background.

### Introduction

Since mid-2007 we have been facing an extraordinary and prolonged financial crisis of a truly global scale. And global problems require global solutions. This is the basis of the requests made on several occasions by the G20 for the regulatory community to strengthen efforts to deliver harmonised reforms at global level. Obviously, one of the fields on which regulatory convergence is most needed is that which affects transparency rules for issuers in world capital markets. It is clear that the integration of international capital markets is required to achieve an efficient allocation of savings around the globe and for that to happen, companies should communicate with investors using a common and properly applied accounting code. This implies that investors demand not only international convergence of accounting principles but also assurance that financial reports are adequately prepared and audited regardless of the jurisdiction where the company is incorporated or listed.

Arguably, in the accounting and auditing fields a significant degree of international convergence has been already achieved. It is remarkable that we have now more than 100 countries using the International Financial Reporting Standards and around 125 jurisdictions where International Standards of Audit are either adopted or used as a reference for domestic regulations. And IFAC deserves much credit for that.

As you all know, IFAC members were significantly involved in the origins and initial steps of the two main international standard-setters dealing respectively with accounting and auditing: the IASC, predecessor of the IASB, and the IAPC, the predecessor of the IAASB. Both standard-setters followed parallel paths –with significant involvement of IFAC-, until 2000 when the Constitution of the IASCF (now IFRS Foundation) was approved and the IASC became the IASB.

## The search for a sound governance structure

Actually, if something has characterised the developments in the institutional structure around standard setting in the accounting and auditing fields it is the search for a sound governance structure. That has always been understood as a necessary condition to ensure the technical quality and independence of the work conducted by the standard-setters while at the same time providing for the proper accountability and contributing effectively to the satisfaction of the public interest.

That was very much the motivation behind the creation, in the financial reporting field, of the IASC Foundation in 2000 and of the Monitoring Board in 2009. And this was also the motivation behind the IFAC Reforms of 2003 and the effectiveness review finalised by the end of 2010.

The IFAC reforms were born out of the erosion of confidence that arose from the financial reporting and auditing problems that occurred around 2002, such as those relating to Enron, WorldCom or Parmalat. As you well know, this confidence problem led IFAC and a group of six regulatory and international financial public interest institutions (what we now call the Monitoring Group) to begin in 2003 a dialogue regarding the need to enhance public confidence in financial reporting and auditing. The result of this dialogue was the IFAC Reforms, which entailed the creation of the PIOB. By providing independent oversight, the PIOB works to mitigate potential conflicts of interest with the aim to ensure that accountability, transparency, and responsiveness to stakeholders' needs are present throughout the entire process of standard-setting.

The IFAC Reforms therefore delivered a three-layer structure composed of standard-setters under the aegis of IFAC (with consultative working groups), the PIOB and the Monitoring Group.

Five years later, the Monitoring Group initiated an effectiveness review of the implementation of the reforms. A draft containing the conclusions of that review was posted for public consultation in June 2010. As a result of this review, the Monitoring Group reached the conclusion that virtually all of the changes called for by the 2003 Reforms had been implemented. The Monitoring Group noted the numerous achievements by IFAC, the standard-setting Boards, their Consultative Advisory Groups (CAGs) as well as the International Public Interest Oversight Board (PIOB) with respect to the implementation of the Reforms.

Moreover, the Monitoring Group suggested several forward-looking recommendations. In particular, it proposed IFAC –among other actions- to seek a higher number of external (i.e. non-IFAC) nominations for the IAASB and the Ethics Board, to adopt more stringent criteria to classify candidates as non-practitioners and to appoint an independent chair for the Ethics Board.

During 2011, there has been regular interaction between the IFAC, the PIOB and the Monitoring Group in order to see how to implement best the above-mentioned recommendations. I have witnessed how that interaction has taken place in a very smooth and constructive manner. This fruitful dialogue will, in all likelihood, permit a full implementation of all recommendations within a relatively short period of time.

## The challenges ahead

The search for a sound governance structure of the standard-setters has therefore already been and should remain a priority for all parties involved –both public and private-. This is particularly necessary in a context of rapid changes in the economic and financial environment in which reporting firms operate and the increasing emphasis put by regulators and market participants on the availability of standards that would strengthen transparency in capital markets.

Moreover, adoption of international standards in a sovereign state implies typically a political sacrifice in terms of regulatory autonomy which is transferred, away from the national jurisdiction, to a private organisation. Moreover, in the case of audit and ethics standards, the profession itself has an important role in the standard-setting work. This could generate potential conflicts of interest that should be properly controlled. Therefore, it is natural to expect that, before accepting that cession of autonomy, domestic authorities would carefully scrutinise how standard-setting bodies are organised, how members are selected, how due process is monitored and what mechanisms exist to protect the public interest. I am convinced that there is simply no possibility of achieving fully converged standards for financial reporting and the accounting profession at the global level if we do not continue striving for a fully satisfactory governance structure.

As I said earlier, in the accounting field it is remarkable that the International Financial Reporting Standards have already been adopted in more than 100 countries. At the same time, the success will not be complete until IFRSs are fully adopted for domestic issuers in important jurisdictions such as United States and Japan. Of course, the decision to be taken by the US and Japanese authorities on the matter will be based on a number of economic and political factors which are not under the control of the IFRS Foundation. At the same time, both the Board of Trustees and the Monitoring Board have understood that the current juncture and, particularly, the prospects for the adoption of IFRS in those relevant jurisdictions provide a unique opportunity to introduce further improvements in the way the Foundation operates.

As you all know, the Board of Trustees and the Monitoring Board have recently launched parallel exercises that aim at reviewing the current governance structure of the IFRS Foundation. It is expected that those exercises will converge in a single set of measures that will be published at around the turn of the year.

The question which is paramount for the review is whether the current three-level governance structure of the IFRS Foundation effectively promotes the standard-setter's primary mission of setting high quality, globally accepted standards as set forth in the Constitution, and whether the standard-setter is appropriately independent yet accountable.

The Review will set out a series of recommendations in different areas: the IFRS Foundation's mission, governance and organisation, the standard-setting process, the financing of the IFRS Foundation and the role and the composition of the Monitoring Board.

I will not enter into much detail, but let me outline a few ideas which are now being considered by the Trustees and by the Monitoring Board.

An important guiding factor of the review is that the Foundation should establish a clear commitment to providers of capital as the primary, albeit not exclusive, users of financial information. Therefore, the IASB should primarily focus on the need of capital providers to take informed investment decisions. In that line, transparency in financial reporting should be the key objective. At the same time, the IASB should work with regulators and other stakeholders, to the maximum extent possible, to enable other authorities to satisfy their information requirements from reporting companies.

The review also deals with the respective functions and interaction between the IASB, the Board of Trustees and the Monitoring Board. It further deals with formulas to differentiate the roles of IASB Chair and CEO of the Foundation, and to separate the standard-setting tasks from other Foundation activities, in particular oversight. As for the Monitoring Board, the review is considering proposals to expand the membership to include more capital markets authorities with a focus on increased representation from major emerging markets, while limiting the overall size of the body to ensure efficiency and effectiveness.

In addition we are now considering different alternatives with respect to the contribution of the Monitoring Board to the establishment of the IASB's agenda and its role in the nomination of the IASB Chair.

In the Monitoring Board we do believe that the ongoing review would make it possible for the IFRS Foundation to achieve a more robust governance structure that would clarify the objectives of the IASB and strengthen its technical and financial independence. Moreover, it will help clarifying the oversight structure so that the accountability of the independent standard setters and the satisfaction of the public interest will be substantially reinforced.

It is clear that the efforts taken by the IFRS Foundation to improve its governance structure constitutes a useful reference for those who have technical and oversight responsibilities in the standard setting work conducted by the IFAC Boards under the IFAC aegis. In particular, I find that, as in the case of IFRS, we should do our best in order to foster a wider and more direct adoption of international standards on auditing and ethics.

As I said already, it is remarkable that around 125 jurisdictions use ISAs as the basis of their national audit regulations. Yet, we should not be fully satisfied. For instance, it is a fact that the adoption of the Code of Ethics for professional accountants has followed a slower path than that for ISAs. Moreover, despite the outstanding results achieved by the clarity project, around one third of G-20 countries do not yet use nor are formally committed to use clarified ISAs in the foreseeable future. Moreover, the attitude towards ISAs in some relevant jurisdictions is not yet fully supportive. Even in the European Union, there does yet not seem to exist consensus to incorporate ISAs into Community Law as is the case of the IFRSs. This is particularly unfortunate at a time in which European audit legislation is currently subject to an ambitious reform process following the forthcoming publication of a regulatory proposal on the matter by the European Commission.

I am aware, however, that it would be wrong to directly extrapolate to the IFAC world the conclusions arrived at in the financial reporting field by the Monitoring Board or the Board of Trustees. We have to be conscious that, despite some similarities, the scope of the work carried out by the IFRS Foundation and the IFAC structure is different and so should be the way the standard-setting work is organised and supervised. Indeed, contrary to what was once the ambition of the Monitoring Group –as reflected in the effectiveness review- an eventual convergence of the Monitoring Group and the Monitoring Board looks, from today's perspective, a highly unlikely outcome, at least in the short to medium term.

Moreover while, as I have already stressed, we have the obligation to look further into ways to improve the organisation, we should not lose sight of the fact that the IFAC structure is functioning well at present. In particular, there should be no doubt on the technical competence of members of standard setting committees. In addition, thanks to the work conducted by the PIOB, public interest is effectively protected. Finally, the implementation of the recommendations stemming from the effectiveness assessment will further strengthen the overall organisation. It is therefore clear that any further reform should be carefully tailored so as not to fix what is not broken.

### **Proposing a public consultation**

So what should we do?

Essentially, we have to make sure that the current governance structure contributes to a clear public perception that the standard setting work is sufficiently sound and compatible with the public interest.

In the short term there are a few improvements that could be done for that end on which we are currently making progress.

For example, it has been long expressed a general dissatisfaction with the way the PIOB is currently financed. Certainly, it is not straightforward to justify that the moderately-sized budget of this organisation is mainly financed by IFAC, i.e. the accounting profession itself. In fact, this financing structure does not positively contribute to convey the image of independence of the oversight body from the overseen standard setters. In that regard, I am happy to communicate that IOSCO is now taking the lead to actively seek a financing formula under which in the near future at least half of the PIOB budget would be financed by

international public organisations represented in the Monitoring Group (i.e. the European Commission, the World Bank, the Basel Committee, IAIS, the Financial Stability Board, and IOSCO).

As for the Monitoring Group, you would all agree that it is odd not to have, as a full member, a representative of audit regulators. I am also glad to inform you that this situation will come to an end very soon. The international forum of independent audit regulators (IFIAR), currently an observer in the Monitoring Group, has already accepted –following, believe me, a complex process- our invitation to become a full member of the group.

Those are, arguably, partial but relevant steps to strengthen the whole structure and improve its public image. But there are other elements that may need to be reviewed, following a public consultation which is now under preparation.

For instance, what I have been calling in this speech IFAC structure is actually a set of bodies named with different acronyms (PIACs, CAGs, PIOB, MG...) the functions of which are spelled out in several documents of a different nature. Thus, the MG has a stand-alone charter. The PIOB responsibilities and organisation are described in an annex to the MG charter as well as in the so-called IFAC reform proposals document and in the by-laws of a foundation created under Spanish Law. I do believe that we need a comprehensive charter – or a Constitution- in which any reader could find an articulated description of how the structure is organised.

The consultation will also provide us with a good opportunity to clarify the respective responsibilities of the standard setters, the consultative groups, the PIOB and Monitoring Group and to describe how the interaction between those bodies takes place. In connection with this, it will be useful to seek the views of different stakeholders on the possibility to modify the scope of the oversight functions of the PIOB, for instance by including IFAC's public sector accounting standards (IPSAS).

Finally, that review should help us to see whether there are further refinements to make in the composition of the different bodies, in particular the PIOB and the MG.

As you can see, by no means are we aiming at provoking a radical modification of the current organisation. At the same time, we see now an opportunity to ask market participants and other stakeholders if they still envisage some concrete measures that could further strengthen the public's comfort with the existing framework, which protects the independence, transparency and accountability of the standard-setting activities sponsored by IFAC. The aim is to identify some measures that could contribute to increase the visibility and legitimacy of the organisation and to enhance confidence by market participants and public institutions, which seems to be a pre-requisite for a more generalised and direct adoption of the standards.

This exercise is now being prepared by the Monitoring Group in close cooperation with IFAC and the PIOB, for which we have established a three-party Task-Force. We are committed to achieve as much coordination as possible, so that the final consultation paper would succeed in dealing with all important issues, introduce the relevant questions and provide the necessary background. Naturally, that coordination will continue after the consultation in order to deliver actual reform proposals.

Let me finish by inviting you all to participate actively in this forthcoming consultation.

Thank you very much for your attention.