



Public Interest Oversight Board

overseeing international audit, ethics and education standards for the accounting profession

OVERSIGHT IN THE PUBLIC INTEREST: THE PIOB MODEL

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TAC Meeting

LONDON APRIL 2010

This year marks the fifth anniversary from the inauguration of the Public Interest Oversight Board. The Forum of Firms and TAC were stakeholders in the original discussions and negotiations that brought about the IFAC reforms of 2003. The PIOB has now operated for five years, oversight as practiced by the PIOB has matured and gathered many experiences, and it is time that we stand back and take stock of the distance we have covered.

I believe it is timely that I have come to talk with the TAC. In fact I may be somewhat delayed and we should have established more direct contact earlier. Of course, we have had many conversations with TAC leadership before, but never had a more formal contact. Furthermore, there are areas of our oversight where we come into contact with TAC and FoF functions, notably the process of nominations to the standard setting boards. In fact, it was within the process of nominations that the PIOB made one of its first interventions, recommending that Forum propose more than one candidate for each available position and that they try to provide some geographical diversity in the backgrounds of their proposed candidates.

I am therefore happy to inaugurate our direct contact today. I am sure that many among you have heard about the PIOB, especially in the context of IFAC budget discussions, but have only a distant idea about how we actually work, what we do, how we spend the moneys of our budget and what are the purported effects of our activity. I would like to address these items today.

A good starting point is to say that we have developed a model of oversight that differs from other models in the international field. The IFAC reform prescribed an architecture for standard setting that was reasonably complex. In order to come to life, it required that the oversight body be actively involved at various levels of activity and decision-making. As we took it upon ourselves to bring the architecture from being a plan on paper to being a body of best practice, we learned a great deal about a notion that was initially quite abstract: the International Public Interest (IPI). I can point up to three foundational elements. First, the IPI can only be understood on the basis of the existence and the function of global markets and a global economic system. Second, the IPI must encompass qualitative elements such as the quality of financial reporting, the quality of audits and the consistency of information overtime and across international space. Third, the IPI in standard setting is ultimately realized when standards are adopted and implemented. Hence standard setting cannot be divorced from implementation and practice. In the work we do at the PIOB these three elements have come to form the basis and the guide to what we do and to the way we do things.



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IFAC Reform

Reform of IFAC and the process by which it sets international standards¹ 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 substantial reform of the governance 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.



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

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:

1. 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



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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, 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.

2. 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 members 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
- 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.

3. Standard-Setting – "Proper Implementation"

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



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- 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.

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.

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.

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.



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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. 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 international standards convergence.

The CAGs

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



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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 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 and IFAC 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 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 international convergence. The PIOB's oversight of the processes by which standards have been formulated provides valuable assurance as to the credibility and the legitimacy 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. Convergence to an agreed set of 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.

Thank you very much.