

THE PUBLIC INTEREST OVERSIGHT BOARD

**“Overseeing standards of audit, education and ethics for the
accounting profession”**

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Chairman**

**PRESENTATION TO THE PRESIDENTS COMMITTEE OF
IOSCO**

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Madam Chairman, colleagues, ladies and gentlemen,

I am truly happy to join you here today. Hong Kong is a spectacular setting for this year's Annual Conference and I must thank the Securities and Futures Commission of Hong Kong, for inviting me to this special event.

It is indeed a great pleasure to be back among old collaborators and friends in the Presidents' Committee, and to also meet all of you who are new members. I want to share some thoughts with you on the mission and work of the Public Interest Oversight Board, on International Standards of Audit, and on Convergence.

Being here is also a challenge. In the last few years IOSCO has proved itself to be a pioneer in international standard setting in the area of regulation and self enforcement.

The PIOB has been in business now for over a year, and there is much I could share with you about starting up a new international supervisory entity. However, I've warned myself that no matter how serious our mission may be, I'm in competition with this beautiful location, an enticing menu and other important IOSCO issues, of which I know there are many. Therefore, I will stay on my point.

THE ORIGINS OF THE PIOB

I do need to begin with a reminder of why a PIOB was needed in the first place.

As we all know, financial markets around the world suffered major blows in the second half of the 1990's and into the early part of this decade. Some of these were traceable to underlying

macroeconomic factors. Others were linked to deliberate manipulation of financial reporting and the market.

Many critics, and especially regulators, zeroed in on the issue of audit failure. What was needed, they insisted, were more robust international standards of audit, ethics and professional formation for the accounting profession. They also pointed to the need for stronger controls to ensure that standards would be implemented properly.

Regulators had a clear stake in seeing the issues of audit quality addressed. They saw improvements to quality and auditor performance as having a direct impact on the public's confidence in financial markets. The World Bank was also attracted by reforms in the area of audit, which hold promise for stronger financial structures in developing economies.

At the same time, the International Federation of Accountants – IFAC for short – recognized the need to deal effectively with their profession's damaged reputation. They acknowledged the benefits of working with the international regulatory community.

From all this came the idea of the Monitoring Group, an alliance of regulators that included IOSCO, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors. The World Bank and the Financial Stability Forum also became part of the alliance.

In early 2003 the Monitoring Group agreed on a reform agenda with IFAC. A central element was the need for independent oversight over the groups setting international standards. The vehicle to deliver this oversight would be the PIOB.

IOSCO has played a leadership role in the development of the PIOB. It has chaired the Monitoring Group since its inception. The

first chair was Sir Howard Davies of the UK Financial Services Authority, followed by Michel Prada of the French Autorite des Marches Financiers, and since late 2005, Roel Campos of the US SEC, who is now chairing.

THE MEMBERSHIP AND LEGAL FORM OF THE PIOB

The PIOB is made up of eight members, plus two observers nominated by the European Commission. In addition to IOSCO's four nominees, one member was nominated by each of the Basel Committee, the insurance supervisors, and the World Bank. The eighth member was chosen from a slate recommended by IFAC.

We represent nine separate nationalities from four continents and a variety of professions. As a group, we have broad experience from regulation, the corporate world, financial institutions, academia. For this reason I can say with confidence that any issue we look at will be thoroughly assessed – and vigorously debated – from a variety of perspectives.

We have one very important thing in common, and in the end it is this factor that drives what we do. Each and every one of us is fully committed to safeguarding the public interest. I will say more about that subject toward the end of my remarks.

A large portion of the startup effort was invested in setting up a legal presence and physical operation. Logically, the PIOB could have located in any of a number of major financial centers. We looked at a few, but in the end decided on Madrid because of the Spanish government's willingness to support our mission, the many synergies of locating next to the IOSCO secretariat, and the strong moral, administrative and economic contribution of the Spanish Securities Commission, the CNMV.

I want to thank publicly CNMV chairman Manuel Conthe for his continuing support.

Once established in Madrid, we focused on creating a Spanish non-profit foundation as a platform for our operations. Again, both IOSCO and CNMV were key players, with IOSCO standing as one of the founders (Basel Committee and Insurance Supervisors were the others).

I want to thank publicly the leadership of IOSCO and the Secretary General for their valuable support.

PIOB GOALS DURING THE PAST YEAR

The scope of our oversight is quite broad. It starts with the three boards responsible for auditing, ethics and education standards. It extends to IFAC's Compliance Panel, a body that monitors how well member bodies (Institutes of CPAs) are complying with the standards published by these boards.

Finally, we oversee the activities of three Consultative Advisory Groups (CAGs), one corresponding to each Board. These groups provide a forum for ongoing dialogue between each of the boards and external stakeholder groups, including regulators, on technical matters and matters of broader public interest.

Given this mandate, we needed to set ourselves ambitious start-up goals. The objective was to ensure that we could quickly establish authority over the standard-setting process.

After deciding to meet quarterly, we proceeded to intensive briefings from IFAC leaders, and started to monitor all Board and CAG activities. We also set out to establish links with other regulators, for example national audit regulators, standard setters and auditing bodies.

In practical terms, our policy of full monitoring meant that collectively we attended over twenty separate meetings during the year, meaning an engagement of more than 120 days. We watched the players and the process, and then reflected on how the system was working. We determined how best to translate the objectives of reform into workable recommendations for change.

The standard setting Boards are populated by volunteer experts. Because of the strong influence of recruitment of volunteers on board quality, we gave high priority to observing the 2005 nomination process to the standard setting Boards. We exercised power to reject or approve candidates proposed for 2006. Further, we assessed whether the nomination process itself needed change.

We recognized quite early that Consultative Advisory Groups (CAGs), in which regulators and other stakeholders participate, provide an important check on the standard setting process, and act as a screening service by bringing external views to the table. We saw the value of these groups as they represent “the public”, and help us determine whether standards remain within the confines of the ‘public interest’

SPECIFIC POLICY OUTPUTS

Up to this point I have concentrated on what we did during the year to build an infrastructure, develop our knowledge, launch our programs and reach out to various partners in the reform process.

Now I want to point to concrete outputs derived from this work, so that you can judge for yourself what value we have added so far.

The first is our work on ground rules, that is rules of ‘due process’ and terms of reference for each standard setting body. Our startup policy was to hold a full review of the ground rules, ensure their

consistency and clarity, establish the explicit role of oversight in working procedures.

The three boards must now follow a PIOB-approved due process. This process is based on several key elements: an appropriate level of transparency, accountability to the PIOB for work plans, open consultations and due process sign off by the PIOB before a final standard can be issued.

This model was not created in a vacuum. Before deciding on our approach, we first benchmarked it against the processes followed by several other highly respected standard-setting bodies and were satisfied that this approach would be robust and compare well to the others.

We did the same for the each board's terms of reference. We identified several key elements, besides the need to function in the public interest: consistency, monitoring of nominations and board processes, an elevated role for the CAGs.

The PIOB took it upon itself to ensure that other parts of the agreed reform were being put in place. For example, the appointment of independent chairmen for the Consultative Advisory Groups was completed under our advice in late March 2006.

The PIOB also reviewed the nomination process through which new members are appointed to the standard setting Boards. Again, the emphasis has been placed on transparency, clarity of objectives, professional behavior, and candidate qualification.

Perhaps the most delicate and difficult task we began to face this year was how – and how quickly – to progress toward achieving the right balance between practitioners and non-practitioners on

each of the boards. IFAC reforms set 50-50 as an objective, but by late 2005 only the Education board had achieved this target.

We realized that each of the boards were in different places for different reasons. We also realized that there might be strong reasons for not moving all the boards to a common goal within the same time frame. Too hurried or too forced a shift could undermine the orderly working of the boards, and the quality of the standards.

Nevertheless, the PIOB was able to identify aspects of the nominations process where progress could be made.

We recommended looking to expanded pools of non-practitioner experts such as national standard-setters and public sector audit professionals. We encouraged continuing attention to matters of geographic, cultural and gender balance. We also determined that the whole selection process should become more transparent.

GENERAL POLICY: INTERNATIONAL PUBLIC INTEREST

When we first began our work, we understood that the key principle driving our formation was the need to ensure that IFAC's standard-setting groups and processes would place primary importance on serving the international public interest.

As the first year progressed, we quickly discovered the importance of defining "the international public interest" in the context of our own mandate. In this way, we would have a clear framework to help set our priorities, guide our deliberations and shape our specific policies.

- first, it is not enough to consider the public interest only in relation to audit standards. The standards which govern the qualification and behavior of

auditors must also be included. Independence and ethics must factor into the balance. In the end we need auditors who exercise sound and independent professional judgment – not ‘list checkers’ and ‘box tickers’. For that, we need all - rounded standards, not just audit standards.

- second, what is developed must be of high quality, but quality is much more than technical efficiency. Standards may be technically excellent, but if they are complex, or confusing, or too prescriptive, they contribute to failures in compliance. Failures in compliance increase audit risk. Therefore, it is critical that international standards be clear and usable in a variety of contexts. We are of course talking about principle – based standards.
- third, standard-setters must be committed to the public interest, must be competent, must be independent, must be responsive to evolving needs of users and beneficiaries.
- fourth, due process needs to be transparent, orderly, and externally validated.

Taken together, these elements are expected to enhance convergence of standards worldwide. Convergence will create better conditions for global markets, will enhance the public interest as standards will take on more and more the character of international public goods. The risks of audit failures can be critically reduced, as standards converge and as compliance becomes stronger. Convergence can also enhance compliance.

We are confident that pursuing these outcomes will contribute to the stability and integrity of markets, institutions, and economies around the world.

I really need not go into more detail as lunch is pressing, and as detail is available in our first Public Report which has been distributed to you. (It is also available at www.ipiob.org). I invite you to read it and offer us your views and comments.

EPILOGUE

I want to close my remarks with a few broad comments about the model of international standard setting that we are pursuing, which is admittedly a novelty, to some an untested experiment. First of all I point to the importance of world regulators coalescing in a joint venture. This is an excellent example of cross-sector cooperation that enhances the governance of the global regulatory system, and offers operational context to the international public interest.

Secondly, the federation of regulators, have chosen to cooperate with the world accounting profession, represented by IFAC. This is also a novelty. Attracting the profession into a world cooperative venture is a visionary strategy. Standard – setting cannot be divorced from those who have detailed technical knowledge of using standards in a multitude of situations. But the process must be supervised so that it does not diverge from creating proper ‘public goods’ into spaces of private or sectional interests, into conflicts of interest, into seeking only safe ground, into risk – averse attitudes about protection from liability.

The goal is to obtain world standards that satisfy the needs for investor protection, market integrity, and financial stability but to embody at the same time the expertise and the experience of those who really do the audits. Thus, standards which are destined to be part of the international governance of the global financial system

should be standards of excellence. Overseeing the production of standards is the job of the PIOB. This is an ambitious agenda and a long trip, but hopefully not an Odyssey. Full revision of International Standards of Audit, for example, is now projected for the end of 2008. I do believe we will be successful in the next few years.

At the other end from the setting of standards is the process of enforcement. This is an activity that lies outside the PIOB's proper mandate, but is highly relevant to what we do. Audit regulators are now present in every major jurisdiction, and have a direct interest in the quality of audit standards. That is why the PIOB has established, and will strengthen, its links to audit regulators around the world. And I must emphasize that the architecture of standard setting, as I have described it, has plenty of room for the participation of audit regulators as members of 'consultative advisory groups' or as direct observer-participants in standard setting bodies.

This is an exciting time. The creation of the PIOB has started a new phase in international standard setting. The governance of global markets can take a giant step forward if there is movement towards convergence of standards, and if the anchors for convergence are of assured high quality.

Confidence in financial reporting can be rebuilt in the process. We at the PIOB are dedicated towards achieving our part of this broader mission. I know all of you share our goals.

Have a successful annual conference and enjoy your visit to this wonderful land. Thank you all very much.