



Public consultation on the governance (with special focus on organisational aspects, funding, composition and the roles) of the Monitoring Group, the PIOB and the standard setting boards and Compliance Advisory Panel operating under the auspices of IFAC

Executive Summary

The aim of this paper is to request views from stakeholders and the public at large on the governance of those institutions involved in the activity of issuing international standards for accountants in the fields of auditing and assurance, ethics and education, with the final goal of improving audit quality.

The activity of issuing international standards is currently performed by the international standard setting boards operating under the auspices of the International Federation of Accountants (IFAC). The Public Interest Oversight Board (PIOB) and the Monitoring Group (MG) have, respectively, an oversight and monitor function. The MG creates a link between the standard-setters and those public authorities responsible for the adoption and/or supervision of the standards, facilitating a discharge of responsibilities.

The current financial crisis is a stimulus to reflect on the best way to strengthen the governance of the international standard setting activities for accountants. This exercise, that is necessary to ensure that the public interest continues to be properly served, is also currently being undertaken (or just finalised) in a parallel manner by other international and related bodies such as the Monitoring Board of the IFRS Foundation.

To seek stakeholders' views, the document is organised in four sections. The first section poses some general questions related to the overall structure, including some on the current organisation, the independence of the standard setters and accountability. More specific aspects, such as the legal nature of the structure or the best name to increase its visibility are also tackled in this section.

More specifically, in relation to independence, the document deals with the possible potential conflicts of interest that might arise from the fact that employees of audit firms still have a very significant involvement in standard-setting. Regarding accountability, the paper introduces the possibility of considering wider interaction among the different parties and also shows the pros and cons of the current three-tier structure. In addition, this first section raises the issue of whether the PIOB's oversight role should be extended to accounting standards for public sector institutions and bodies.

The second section focuses on the role and composition of the different interplaying bodies in the structure (Monitoring Group, Public Interest Oversight Board, the Public Interest Activity Committees and IFAC) including the relationship between them. In this section, some proposals can be found about what should be the role of the MG, with a special emphasis on pursuing a closer and more strategic involvement with the PIOB and the PIACs. Questions on how the MG should be organised and composed to achieve this goal are also included in this section.

Section three focuses on the funding of the PIOB. The current funding scheme is extremely dependent on IFAC as it finances all the standard-setting activities and most of the public oversight function. Already in the MG final effectiveness review report published in 2010 there was recognition of the need to explore additional opportunities for neutral and diversified PIOB funding to assure a continued flow of appropriate funding for the oversight function. This section presents alternative funding options to achieve a more diversified funding with a broad range of parties involved, seeks public feedback on the alternatives proposed and request for further ideas on alternative funding structures.

Finally, in the last section some open questions are proposed with the aim of recollecting other ideas or suggestions not considered in the previous sections and that could be helpful to strengthen the current structure.

Through the whole document, some background is provided in each section in order to help to understand the related questions. Nevertheless, for those readers with a previous knowledge of the structure and its governance, the full list of questions is included in this executive summary.

List of Questions:

Q1: Do you consider it necessary to enhance representation of the public interest? If so, which additional actions, apart from the appointment of an independent IESBA Chair and redefining the nature of non-practitioner board members, would you suggest to reinforce the mechanisms to safeguard the public interest?

Q2: In the long term, would you favour a different and fully independent standard-setting model completely outside the IFAC structure and if so how could such a structure be funded?

Q3: Do you consider the current three-tier system adequate for achieving its objectives, or an alternative model could be more adequate? In the latter case, which model would you suggest?

Q4: Would you support the IPSASB being subject to PIOB oversight? Why? What conditions, if any, would you impose on such oversight? Would you see as a factor to take into account the fact that IPSASB deals with accounting rules instead of auditing ones?

Q5: Do you see merit in having a “Compilation document” for the whole structure? In this case, which alternative would you prefer for organising the structure and nature of the Compilation document?

Q6: Given the breadth of the current mandate, would you consider it helpful to modify the name of the structure to improve its visibility? In this case, what name would you suggest?

Q7: Do you agree with the proposal that the MG should have a more strategic role?

Q8: Do you agree with the objectives proposed and, specifically, with the MG having the possibility of conferring with the PIOB on the PIACs’ agendas and receiving appropriate feedback?

Q9: Do you agree with the suggested ways of improving the communication activities? Would you consider it useful for the MG to have in the special occasions above described direct involvement with PIACs?

Q10: Do you have any specific suggestions on how liaison with investors could be improved? In this sense, do you see merit in some portions of the MG meetings having the public in attendance?

Q11: Would you find it useful that the MG engages with organisations representing governmental institutions? Would the G20 be the most appropriate or, should others bodies be considered instead?

Q12: What is your opinion about the current composition of the MG? (i) Do you believe that other organisations (i.e., national or regional regulators) should or could be represented in the MG? If so, which criteria do you think new members should fulfil to become MG members? (ii) Should a maximum be set to the number of MG members? (iii) Would you favour a change on how the Chairperson is appointed?

Q13: Do you see a problem in MG members appointing full time employees of organisations represented in the MG as PIOB members?

Q14: Would you consider convenient to avoid direct hierarchical relationship between the PIOB and the MG members?

Q15: Do you think that the roles and responsibilities of MG and PIOB should be further clarified? Do you have specific suggestions regarding which areas this clarification should address?

Q16: Do you see merit in the PIOB undertaking a regular review of its due process and oversight framework through its strategy document?

Q17: Do you see merit in the PIOB periodically producing a strategy document that would supplement the yearly business plan and budget? What should the involvement of the MG be in the production of these documents?

Q18: Do you think that the current composition of the PIOB could be enhanced? Would you consider convenient that the PIOB's composition is reviewed each time a new body becomes full member of the MG?

Q19: Would you consider the current composition of the PIACs appropriate? Do you see merit, in the context of a second effectiveness review, in exploring the idea of having a majority of non-practitioners and a majority of public members?

Q20: Do you consider best practice a nine years period for rotation of the representatives of CAG member organisations?

Q21: Would you agree that it is not realistic at the current time to attempt to alter the funding structure of standard setting activities in any substantial fashion?

Q22: Do you consider appropriate that IFAC finances the largest part of the PIOB budget? If not, do you consider appropriate that IFAC launches an external fundraising having some contributions of the MG members in the mean time?

Q23: Do you think it feasible to have a similar funding structure in place for the PIOB to that in place for funding the IFRS Foundation?

Q24: Do you see the need for and/or merit in having a permanent Secretariat for the MG? In this case, do you think IOSCO should provide resources for a permanent Secretariat to the MG?

Q25: How do you think the governance of the international auditing, ethics and education standards setting process could improve audit quality? What are the main objectives that those responsible for governance should take into account?

Q26: What is your opinion about the current structure? Do you think the current structure is appropriate in order to improve audit quality? If not, what changes, suggestions or remarks would you propose?

Q27: Do you agree that the current levels of empowerment and responsibility of the bodies that compose the current structure (MG, PIOB and PIACs) are appropriate? If so, do you have any suggestions for improving the dialogue and interaction between the different bodies? If not, how these levels of empowerment and responsibility could be improved?

Q28: Do you think that there is any other overall structure that could achieve improvement in audit quality more efficiently? If so, what could they be and how might they be financed?

Introduction

Aim of the paper

The aim of this paper is to request comments and opinions from stakeholders and the public at large on whether improvements are needed with regard to governance arrangements of those involved in the activity of issuing international standards for accountants in the fields of auditing and assurance, ethics and education with the final goal of improving audit quality.¹ The paper also raises the issue of whether the Public Interest Oversight Board's (PIOB) oversight role should be extended to accounting standards for public sector institutions and bodies.

As we refer to later in this paper, the Monitoring Group (MG) finalised an effectiveness review in 2010 of the 2003 International Federation of Accountants (IFAC) Reforms. This paper aims at building on and completing the effectiveness review that began in 2010 through a comprehensive governance review of the full architecture currently in place. The different sections will clarify whether the proposed measures are intended for short term implementation or for implementing as part of a second effectiveness review.

The MG acknowledges that any recommendations for changes further to those made in recent reports will need to be assessed after a reasonable period of time has elapsed in which to gain practical experience on how the 18 near term measures have actually worked. However, there may be some recommendations arising from this paper that could be introduced in the near term measures.

Background - *MG report 2010*

The 2003 IFAC Reforms² stated that the MG shall perform a review of the implementation of the Reforms five years after the formation of the PIOB, in February 2005. This review would cover consideration of all of the items addressed in the 2003 Reforms, as well as any other aspects of IFAC's operations thought appropriate by the MG.

¹ These standard setting boards are part of the group of the denominated Public Interest Activity Committees (PIACs). PIACs operate within the aegis of IFAC. Four of them are under PIOB oversight: the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), the International Accounting Education Board (IAESB), and the Compliance Advisory Panel (CAP). The three boards set international standards in their respective areas and are supported by the CAGs, which are consultative bodies. The Compliance Advisory Panel oversees implementation and operation of the IFAC Member Body Compliance Program. In addition, the PIOB oversees the Nominating Committee of IFAC, which nominates candidates for these standard setting Boards. For a more comprehensive overview of the current structure, see Appendix 1.

² The 2003 Reforms were aimed at providing a mechanism to allow standard-setting to be responsive to the public interest.

These matters were dealt with in a consultation paper that the MG issued in June 2010 and that gave rise to a final report in November 2010 on the Review of the IFAC Reforms (the ‘effectiveness review report’ or the ‘report’). The report commended IFAC for all its efforts and noted:

That virtually all of the changes called for by the Reforms had been implemented. It also noted that IFAC had gone beyond the Reforms in some aspects, such as additional measures on transparency and funding of the PIACs activities.

That some opportunities exist for further improvements to encompass practices that, given new experiences and developments in the financial markets, have come to be associated with other credible and effective standard-setting processes.

According to the report, there were eighteen recommendations to be implemented in the near term that were within the context of the Reforms which would bring additional enhancements to the standard-setting, oversight and monitoring work and thus further the aims of the Reforms with respect to diversity, transparency and accountability. Full implementation of these recommendations is expected during the next twelve months.

The near-term improvements were classified in three categories:

- Diversity
- Transparency
- Accountability

In addition the report identified two longer term issues:

- Whether standard-setting Boards that operate within an accountant’s professional membership organisation can carry out the responsibilities that ultimately come with international standard-setting in the public interest.
- The possibility of an assessment of potential synergies between the MG and the Monitoring Board of the IFRS Foundation.

The report announced that the MG would analyse whether the current governance structure – with “standard-setting Boards that operate within an accountant’s professional membership organisation”³ – can set international standards in the public interest and as to which areas need further improvement. The report further noted that it “is a significant

³ Review of the IFAC Reforms – Final Report (8 November 2010), p. 17.

challenge to take into account the need for technical expertise while the same time ensuring that the public interest is served.”

Background – lessons from the financial crises

The final report on the effectiveness review, issued in November 2010, stated that the MG intended to carefully review the implementation of the near-term recommendations and to conduct future reviews of any aspects of the IFAC Reforms, when and if needed. The Reforms did acknowledge that given the rapidly changing environment the MG could decide at any point that a new effectiveness review should be conducted, even if the Reforms envisaged that a regular review should only take place five years after the formation of the PIOB, in February 2005.

The effectiveness review report notes the 2003 Reforms were borne out of the erosion of confidence that arose from the financial reporting problems experienced by some listed issuers in and around 2002 and 2003 and they were aimed at supporting confidence by increasing the quality of the audits of financial statements and helping to ensure standard-setting is developed in the public interest.

The current financial crisis provides a new impetus to strengthen the governance of the international standard setting activities for accountants. Stakeholders expect the auditor to provide them with assurance concerning the fair presentation of financial statements. At the same time, stakeholders may be interested in assurances regarding the going concern status of the entity, and also about other issues such as fraud or the responsible behaviour with regard to environment, governance and social matters. In this sense, the recent crisis highlights examples⁴ where the public expectations of what the financial statements and the auditor’s opinion provide appear not to have been completely fulfilled – the “expectation gap”. This raise questions about whether audit and ethics standards have worked sufficiently well, how they have been applied, and by extension raises questions about the suitability and adequacy of the current governance and regulatory framework under which the auditing mandate operates.

Another relevant development is that the Monitoring Board of the IFRS Foundation structure and its Board of Trustees have completed public consultations about governance

⁴ For instance, some financial institutions, because of liquidity problems and/or having incurred material losses on the positions they had held both on and off balance sheet, have gone bankrupt or would have gone if they would not have received Governmental support, all without getting a going concern or otherwise auditor’s qualification.

and long-term strategy, among other things. It seems appropriate to reflect on such initiatives.

At the same time, the MG acknowledges that the final effectiveness review report was published very recently, and the overall conclusion, as previously anticipated, was highly satisfactory and that virtually all the measures set out in the 2003 reforms had been fully implemented. Furthermore, the eighteen recommendations are still under discussion and not fully implemented. It seems logical that any further recommendations for changes will need to be assessed after a reasonable period of time has elapsed in which to gain practical experience on how the 18 near term measures have actually worked. However, there may be some recommendations arising from this paper with respect to the MG, PIOB, CAGs or PIACs that could be introduced and facilitate the near term measures' implementation.

Structure of this paper

This governance review is composed of the following sections:

- 1. The structure. Objectives, legal nature and name**
- 2. Bodies in the structure (role and composition)**
 - 2a) Monitoring Group**
 - 2b) PIOB**
 - 2c) PIACs (and their respective CAGs)**
- 3. Funding of the structure**
- 4. Overall structure: Final Questions**

1. The structure. Objectives, legal nature and name

i) Objectives of the structure: high quality standards to promote stakeholders' confidence

As mentioned in the introduction, the standards are issued by three PIACs (following a public consultation period and advisory input from their respective CAGs). The PIOB evaluates the due process in standard-setting activities to be satisfied that the procedures ensure that the views of all stakeholders are sought and considered and that the standard-setting bodies are accountable for their disposition of those views⁵. The MG monitors the entire process through its various capacities, as were defined in the IFAC reforms and implemented in the MG charter.

The objectives of the structure are to promote stakeholders' confidence in the quality of the standards and that they are developed in a manner that is responsive to the public interest. There are two key elements to achieve this goal: independence and accountability. As a consequence, stakeholders must perceive that the standard setting process is conducted with true objectivity and that there is proper accountability to investors and other users.

The governance structure should provide for a standard-setting environment that is independent of and protected from vested interests. At the same time, the long-term viability of assurance, ethics and educational standards as global standards will very much depend on the PIACs exercising their independence in a manner that serves the public interest by being accountable to investors, market participants and other stakeholders.

The purpose and *raison d'être* of the Monitoring Group is to create a link between the standard-setters and those public authorities responsible for the adoption and/or supervision of the standards. Via this link, public authorities are more readily able to discharge their responsibilities by monitoring the functioning of the standard-setting process, thereby contributing to the confidence required by these public authorities to supervise or authorize their use and being satisfied if the standards have been developed through a robust due process not beholden to parochial or vested interests.

Independence

In the current structure, which the MG has engaged in since 2003, those employed by audit firms have a non-controlling but significant involvement in standard-setting. This

⁵ IFAC Reforms (September 2003), p.10.

could raise doubts about possible conflicts of interest—both actual and perceived—which are inherent in the current scheme. One issue to be analysed is then whether in the long run the standard-setting work can be adequately “safeguarded” from those conflicts of interest.

Acknowledging the need to enhance the perception of independence for the IESBA, IFAC has agreed that the next Chair of the Board should be and be seen as independent. A global search for a remunerated independent chair commenced in October 2011 with the expectation that the position will be filled by January 2013. The MG is pleased that IFAC has responded so promptly to fulfil this recommendation contained in the 2010 report, which represents a significant landmark towards a more independent structure.

Other structural changes that would give rise to the standard setters being completely outside the IFAC sphere of influence do not seem likely in the short/medium term as these would imply a major effort especially in terms of expertise and funding, and the MG expects to be in a better position to ascertain and propose the most appropriate changes as a result of this review. However, in the current context, it seems advisable to reinforce as much as possible the mechanisms that provide for responsiveness to the public interest during the standard-setting process, with measures such as the previously mentioned appointment of an independent IESBA chair or the enhancement and strengthening of the definition of non-practitioners to ensure they bring substantial experience outside the auditing profession and have severed any material economic link with that profession.

Q1: Do you consider it necessary to enhance representation of the public interest? In that case, which additional actions, apart from the appointment of an independent IESBA Chair and redefining the nature of non-practitioner board members, would you suggest to reinforce the mechanisms to safeguard the public interest?

Q2: In the long term, would you favour a different and fully independent standard-setting model completely outside the IFAC structure and if so how could such a structure be funded?

Accountability

As mentioned before, the objective of the current structure is to increase confidence in that the standard-setting activities of IFAC are properly responsive to the public interest.⁶

This objective is sought through the different bodies of the structure, beginning with the establishment of the objectives and responsibilities of the standards setting boards. In this sense, PIOB has the responsibility of overseeing the public interest activities of and the due process followed by the PIACs, including the appointment of their members. The entire process is monitored by the MG, which should also provide strategic guidance on regulatory developments and changes in the economic context that may have an impact on the standard-setting activities. A more frequent interaction would also provide additional opportunities for exchanging experiences in overseeing standard setting activities and how to tackle new challenges arising from the changing environment.

There might be a case for considering a change in the current three-tier structure (i.e. a structure in which there are three interplaying layers with four counterparties, the MG, the PIOB and the standard-setters under the aegis of IFAC, and IFAC itself, which plays a relevant supportive role in the structure, providing inter alia: management of the nomination and selection process, human resources and facility management and financing).

A three-tier system has the advantage of making a clearer distinction between direct oversight and high-level monitoring activities. In this regard, the monitoring function carried out by a body of public officials can contribute to ensuring that existing procedures relating to the public interest work properly. Moreover, it may also strengthen the accountability of the structure vis-à-vis public authorities.

An item that could be explored is constituents' views on whether there could be an alternative system (e.g. a two-tier structure composed of only two layers, the standard-setters and another one overseeing them).

Q3: Do you consider the current three-tier system adequate for achieving its objectives, or an alternative model could be more adequate? In the latter case, which model would you suggest?

⁶ IFAC Reforms (September 2003), p.9.

Public Sector Accounting Standards

There could be a case for including within the current oversight/monitoring structure the activity performed by the only IFAC standard setting board that is not currently being overseen by the PIOB, namely the International Public Sector Accounting Standards Board (IPSASB).

In the current environment there is a significantly increased focus on public sector financial reporting and the adoption of International Public Sector Accounting Standards (IPSAS) due to the emerging problems with some sovereign debt. Public interest oversight would help to provide assurance to those adopting the IPSAS that the processes used by the IPSASB take account of the public interest.

The impact of the global financial crisis has been one of the key drivers of financial reporting developments in the private sector in the last couple of years. The volume of public sector securities in capital markets means that this has also been a crucial influence on IPSASB's work. The ongoing sovereign debt situation continues to highlight the need for enhanced transparency in public sector financial reporting. It has also highlighted that high-quality financial reporting by governments and other public sector entities is of the utmost importance to Parliaments and citizens, now more than ever.

This sharper focus on accounting standards for the public sector has led the Trustees of the IFRS Foundation to question whether the IASB should start addressing these standards as part of the Trustees' Strategy Review. However, a majority of respondents supported that the IASB should continue focusing in the near term in the accounting for private sector entities. Nevertheless, the possibility of placing the oversight function inside the Foundation could be considered in the medium or long term.

In any case, the significant role of the public sector in capital markets emphasizes the importance of the question regarding public interest oversight of the IPSASB.

IFAC consulted with some governments and other stakeholders to seek views on independent oversight of the IPSASB. Two possible models for oversight of the IPSASB were considered, namely, oversight of the IPSASB by the PIOB or, alternatively, by a public sector exclusive oversight body.

Of the respondents, virtually all agreed with the need for independent oversight of the IPSASB which could add to its credibility and facilitate its wider international adoption. Of those that expressed a view, the PIOB adapted model was supported by a ratio of

two to one. This was also supported by the Asian Development Bank and the World Bank. The public sector exclusive model of oversight was preferred by four respondents including the OECD.

If the scope of the PIOB's activities is expanded to include oversight of the IPSASB, there would be additional costs incurred. These would potentially result from the addition of members to the PIOB, attendance of PIOB members at IPSASB meetings as well as additional staff costs at the PIOB. It is estimated that the annual incremental cost of the PIOB providing oversight of the IPSASB would be approximately US\$300,000 to \$350,000.

The benefits of PIOB oversight of IPSASB would be:

- Existing structures can be accessed to implement oversight in a reasonably efficient manner. Costs of meeting with the oversight body would only be incremental to those already being incurred;
- The IPSASB's operations and processes (already very similar to those of the PIACs) would evolve to be even more consistent with that of those boards;
- IFAC would be able to focus on responding on oversight issues to one body; and
- The PIOB would need little effort to understand the processes of the IPSASB, because they are very much in line with those of the other standard setters it oversees.

A number of challenges and issues would need to be addressed, including:

- Whether it could result in a more heterogeneous set of standards subject to oversight, which would be better solved by a public sector exclusive model of oversight;
- What is the appropriate composition of both the PIOB and the MG, for example, whether the MG or PIOB composition needs to be modified or increased to include some members with public sector specific experience;
- Funding the additional costs.

Q4: Would you support the IPSASB being subject to PIOB oversight? Why? What conditions, if any, would you impose on such oversight? Would you see as a factor to take into account the fact that IPSASB deals with accounting rules instead of auditing ones?

The discussions in the remainder of this paper do not make further reference to the IPSASB or IPSASB oversight. This is not intended to dismiss the direction that responses to these questions may provide. Any of the issues that follow in this paper can be adjusted to reflect an MG role in IPSASB oversight

ii) Status

At present, the structure and status of the monitoring, oversight and standard setting structure are not very clear to many stakeholders.

Currently, there is not a single document containing all the basic features and rules applicable to the different bodies; rather, they are dispersed in a number of documents: the MG charter, the PIOB foundation by-laws, the IFAC Constitution and by-laws and the terms of reference of the different PIACs and CAGs. A more comprehensive set of documents would make it easier to understand how all this system works.

One proposal would be to foster an agreement or memorandum of understanding (MOU) between IFAC, the PIOB and the organisations represented in the MG to establish a new Compilation for the whole structure that would consolidate all the basic rules and procedures applicable to the MG, the PIOB and the PIACs and their respective CAGs. In addition, there could be a need of implementing more detailed provisions in some of these documents where separate authorities exist; for example, the MG's right to establish its own operating procedures.

This Compilation document would compile the relevant content of all the aforementioned scattered documents and would include:

- Objectives
- Composition
- Relationship between the different bodies
- Functions
- General working rules
- Funding

Regarding the specific nature of this Compilation document there would be basically two alternatives:

- It could be organised through (or based on and with the support of) the PIOB Foundation, as the only tier that has formal legal status⁷, or
- It could adopt the form of a standalone charter (or perhaps a MOU with the Charter or Compilation document as an annex) establishing the governance of the whole structure.

Q5: Do you see merit in having a “Compilation document” for the whole structure? In this case, which alternative would you prefer for organising the structure and nature of the Compilation document?

iii) Name

The structure as defined lacks a comprehensive name that could provide clarity to third parties. This has not facilitated widespread public knowledge of the structure and given that one of the goals of this paper is to promote a higher visibility of the structure, a comprehensive name may help in this regard.

In general terms, this structure could be named “IFAC structure” but this would fail to reflect the important fact that there is a function in place to provide for responsiveness to the public interest with respect to due process. Therefore, this relevant public interest feature should somehow be incorporated into the name.

One possibility would be “International public interest standards for the accounting profession”. Other possibilities would be “Standard-setting activities in the public interest for the accounting profession” or “International standard-setting architecture in the public interest in the field of audit and assurance, ethics and education”.

These names would lead to the MG being referred to as “MG of international public interest standards for the accounting profession”, “MG of standard-setting activities in the public interest for the accounting profession” or “MG of the international standard-setting architecture in the public interest in the field of audit and assurance, ethics and education” and the PIOB could be renamed as “Public interest international standard-setting in the field of audit and assurance, ethics and education oversight

⁷ There could be different alternatives under this possibility, for instance, the Compilation document can be posted on the PIOB’s Website in a section describing the IFAC structure under its supervision, etc. MG Members would appreciate views on this, as responses to the next set of Questions..

board” (although its short name could remain as PIOB as it is probably the best-known name in the entire structure).

The MG acknowledges it is not feasible to address in a single name the whole range of activities under the scope of the structure. For instance, none of these above proposals make an explicit reference to the mandate of the Compliance Advisory Panel nor do they anticipate the inclusion of IPSASB within the remit of the MG and PIOB.

Q6: Given the breadth of the current mandate, would you consider it helpful to modify the name of the structure to improve its visibility? In this case, what name would you suggest?

2. Bodies in the structure (role and composition)

a. Monitoring Group

i) Role

The Monitoring Group (MG) is a consensus-based group that brings together the regulatory and international public interest organisations responsible, *inter alia*, for monitoring the implementation of the aforementioned IFAC Reforms.

The Monitoring Group is committed to advancing the public interest. It meets this objective by supporting the development of high quality international standards for auditing and assurance and accountants' ethics and education, and by exchanging views relating to international audit quality, regulatory and market developments having an impact on auditing.

The Monitoring Group's Mission is to:

- Cooperate in the interest of promoting high-quality international auditing and assurance, ethical and education standards for accountants.
- Monitor the implementation and effectiveness of the IFAC Reforms, and in that connection to undertake an effectiveness assessment of the IFAC Reforms and other aspects of IFAC's operations that involve the public interest.
- Through its Nominating Committee, appoint the members of the Public Interest Oversight Board.
- Monitor the execution by the PIOB of its mandate.
- Consult and advise the PIOB with respect to regulatory, legal and policy developments that are pertinent to the PIOB's public interest oversight.
- Convene meetings to discuss issues and share views relating to international audit quality as well as to regulatory and market developments having an impact on auditing.

The Monitoring group also approves the annual PIOB budget

One of the major consequences of the financial crisis that began in 2007 is a generalised lack of trust/confidence on the part of investors. As mentioned before, this could provide an additional incentive to increase the efforts to enhance confidence in financial reporting and auditing. Therefore, there seems to be a strong case for the MG to explore opportunities for a more significant and active role in this connection.

In this regard, its main task should continue to be monitoring the PIOB, including its oversight activities and the execution of its mandate. At the same time, it should also give strategic guidance to the PIOB and IFAC International Regulatory Liaison Group.

More concretely, the MG would pursue the following objectives:

- Closer and more strategic involvement with the PIOB, i.e. (i) reinforcement of its role providing inputs and guidance to the PIOB, the IFAC International Regulatory Liaison Group, and, through them, to the public interest organisations within the IFAC structure, about recent developments in regulatory issues and changes in the economic context, trends and concerns; and (ii) monitoring its PIOB oversight methodology, giving regard to the PIOB's consideration of whether due process in the standard-setting activities of PIACs is robust and responsive to the public interest, and whether regular benchmarking against relevant organisations are performed in order to continually improving its methodologies and oversight activities.
- Closer involvement with the PIACs. Even if a direct involvement was envisaged in the Reforms, in order to avoid causing excessive costs, this would mainly be substantiated by consulting and exchanging views with the PIOB regarding its responsibilities for oversight of the processes employed by the PIACs. However, the MG could meet on very special occasions with the Chairs and some other selected members of the different PIACs, for instance when the concerned PIAC and the MG meet in the same location. Additionally, concerning work programs and priorities, the MG would have the ability to refer through the PIOB, a public interest issue for the PIACs to consider including in these Board's agendas. Such referrals would be only in relation to urgent and relevant issues as unanimously supported by all MG members. The MG should also have the right of receiving specific feedback on whether the topic was added to the agenda or otherwise the reason justifying its omission. In any case, the MG would not have any right to influence the technical content of the standards, although individually the MG members would continue to engage with the PIACs on technical matters.

Additionally, it could be reasonable to establish a minimum number of meetings per year between the MG and the PIOB.

Q7: Do you agree with the proposal that the MG should have a more strategic role?

Q8: Do you agree with the objectives proposed and, specifically, with the MG having the possibility of conferring with the PIOB on the PIACs' agendas and receiving appropriate feedback?

The Monitoring Group has organized itself to operate and to engage in a way that is different from, and complementary to, that of the PIOB and the other organisations within the IFAC structure. However, the Monitoring Group could better communicate its approach to monitoring so that it can better engage with the PIOB, as well as getting a better understanding of relevant issues at stake through a more active involvement, mainly through the PIOB, with the standard-setting Boards and their Chairs and CAGs, IFAC, but also direct contacts with other relevant stakeholders, such as investors, that may have an interest in the MG's activities.

In this regard, the following proposals could be considered:

- Meeting more frequently than the minimum requirement according to the charter.
- Issuing more frequent press releases, for example when the PIOB's strategic and business plans are approved (see below).
- Increasing direct contacts with relevant stakeholders, including investors. Furthermore, and in addition to the indirect engagement through the PIOB, the MG could meet on very special occasions with the Chairs and some other selected members of the different CAGs, for instance when the concerned CAG and the MG meet in the same location. Additionally, there could be arrangements in place to receive targeted input from key stakeholders on key topics.
- Organising conferences or other public events on issues under its domain.
- Improving the website visibility of the MG (possibly using a similar format to the MB's site).
- Considering public attendance at the MG meetings, except those parts being held in private for confidentiality reasons.

Q9: Do you agree with the suggested ways of improving the communication activities? Would you consider it useful for the MG to have in the special occasions above described direct involvement with PIACs?

Q10: Do you have any specific suggestions on how liaison with investors could be improved? In this sense, do you see merit in some portions of the MG meetings having public attendance?

ii) Composition

The MG's main tasks and *raison d'être* are to contribute advancing the public interest in international standard-setting in the area of ethics, audit and assurance, and education, in addition to monitoring developments with respect to their adoption and compliance. For that aim, with the IFAC's cooperation, the PIOB was set up.

Currently, the MG comprises the International Organisation of Securities Commissions (IOSCO), the World Bank (WB), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the Financial Stability Board (FSB) and the European Commission (EC). IFIAR, the International Forum of International Audit Regulators was an observer until November 2011, although has recently been invited and subsequently accepted to become a full member. All those organisations have a legitimate and direct interest in the field of auditing with regard to either the adoption of standards or their supervision, but there could be a case for considering the incorporation of other types of organisations.

Accordingly, it might be advisable to explicitly set out the criteria for membership of other organisations. It could also be useful to set up a maximum number of MG members, in order to avoid the possibility of an excessive number hindering efficiency in the MG decision making process.

Furthermore, the MG is currently composed solely of international and global organisations, with the exception of a regional organisation, the European Commission. So the question is whether it would be advisable, in terms of the MG's performance, to also include regional or national organisations in charge of standards adoption, regulation or supervision with a legitimate interest in the working area of the MG.

This idea has pros and cons. A positive aspect would be the potentially significant expertise that these kinds of organisations could bring to the MG, as they usually deal with endorsement, regulatory or supervisory matters on a daily basis. In this regard, national or regional representatives would further align the composition of the MG to that of the Monitoring Board of the IFRS Foundation. However, even if more alignment could be envisaged, it may not be realistic in the foreseeable future to completely align the composition, functions or charters of both groups, especially given that the Monitoring Board has just recently completed its review of this matter.

A potential drawback would be a possible weakening of the global perspective that currently characterises the MG. Moreover there is the practical difficulty of choosing between audit oversight, prudential and capital markets regulators as they all have a case for representation in the MG.

Furthermore, as a means to strengthen the accountability of the whole structure, the possibility of getting some level of engagement with organisations representative of governmental institutions, such as the G20, could be explored, thereby getting some acknowledgement of the existence and useful work carried out by the structure.

Another issue regarding the composition of the MG would be the election of the Chairperson. Currently, given the predominant role of IOSCO in the 2003 Reforms, which has also the right to appoint a higher number of PIOB members than the other MG members, IOSCO also has the right to appoint the MG Chairperson but there could be a case for considering other arrangements.

There is one final internal issue about composition that needs to be considered. The current rules, set out by the IFAC Reform, state that PIOB members must be a mix of senior staff of the nominating members of the MG and others appointed by these members and representing the public interest.

Given the level of representation that normally prevails in the MG, this rule could lead to situations in which two different persons from the same organisation who are hierarchically related (i.e. superior/subordinate) sit on the PIOB and the MG.

This situation allows each member to nominate the most capable professional in relation with the different PIOB and MG roles and attributions, which could reinforce each group beyond internal hierarchies.

At the same time it could be argued that, in those cases, the respective independent roles of both the PIOB and MG could be jeopardised and that there is a risk of conflicts of interests arising at some point in time.

One possibility is maintaining the current situation. In this case, each entity should internally evaluate if this situation could trigger any conflict of interest before nominating the particular candidates.

Another feasible alternative would be to establish a rule under which it would not be possible to appoint as members of the PIOB individuals who are currently employed by nominating members of the MG. Or, at least, establish that there should not be a hierarchical relationship between individuals in the PIOB and individuals in the MG. Should this not be feasible, in any event, it should be set as a good governance principle that the individuals in the MG should be of a higher (or at least equal) rank than the representative in the PIOB.

Q11: Would you find it useful that the MG engages with organisations representing governmental institutions? Would the G20 be the most appropriate or, should others bodies be considered instead?

Q12: What is your opinion about the current composition of the MG? (i) Do you believe that other organisations (i.e. national or regional regulators) should or could be represented in the MG? If so, which criteria do you think new members should fulfil to become MG members? (ii) Should a maximum be set to the number of MG members? (iii) Would you favour a change on how the Chairperson is appointed?

Q13: Do you see a problem in MG members appointing full time employees of organisations represented in the MG as PIOB members?

Q14: Would you consider convenient to avoid direct hierarchical relationship between the PIOB and the MG members?

b. PIOB⁸

i) Role

The MG final report on the effectiveness review issued in November 2010 stated that, in the five years since the PIOB's establishment in 2005, the MG has sought to let the PIOB "find its own voice" in order that it might independently identify and develop the details of its oversight role and its outside interactions.

During this time, the PIOB has established its form of operation and, each year it has published a report setting out the activities performed during the year. The MG has interacted with the PIOB in conjunction with its annual review of the PIOB financial matters and through periodic meetings with the PIOB Chair and Secretary General.

The MG expects that this review of the governance will highlight the PIOB's mandate to provide oversight of the standard-setting process, including standard-setting Board member nominations. It will, at the same time, emphasize the role of the Monitoring Group in monitoring the entire process.

But perhaps this role could be reinforced. One proposal in this connection would be to focus the MG's relationship with the PIOB on more structural, long term and strategic issues, with the MG giving input for the strategic direction of the PIOB about the basic lines that should inspire its work.

For instance, it might be useful for MG members to give presentations of the latest regulatory developments and changes in the economic context in which they are involved in order to provide high-level guidance to IFAC and PIOB representatives.

Moreover, the PIOB should periodically prepare a medium-term strategic plan in which it could reflect its mission, as well as its strategic objectives and key lines and how the PIOB sees itself within a 2-3-year time horizon.

The document would update the PIOB's strategic objectives reflecting its mission which would naturally lead to how those objectives and long-term strategies should be translated into short-term operating targets, how to implement them in practice and, thus, which resources would be necessary. The yearly 'business plan' and correlative annual budget would then be a correlative conversion into figures of those short-term objectives and the resources planned to fulfil them.

⁸ For more information about PIOB, see appendix 1 of this document and the joint PIOB public consultation paper.

As part of its mission, the PIOB could reflect on the meaning of the public interest, although strictly in the context of the audit field and related matters under its oversight and in relation to public accountants' environment and which due process mechanisms would be necessary to establish to help protect the public interest adequately. This means that an ongoing review and update of the current due process applied by the PIACs should be part of the PIOB's role.

Once the PIOB, with the monitoring by the MG, defines the process, it should consider which is the most effective way of ensuring that such process is being effectively complied with by the IAASB, IESBA, IAESB and CAP. In this regard, the PIOB could benchmark its oversight methodology against that of other comparable organisations. For instance, it could explore how the Trustees of the IFRS Foundation and other relevant organisations are currently exercising due process oversight. Indeed, further convergence of approach in this area seems desirable.

In line with the recent policies adopted by other international organisations, periodic strategic plans could also be released for public consultation. The annual business plan should be submitted to the MG as part of the approval of the annual budget, to the extent that the budget should be considered a reflection in quantitative terms of the PIOB's strategies and objectives.

The first PIOB strategic document is being subject to public consultation in parallel to this Governance Review.

Q15: Do you think that the roles and responsibilities of MG and PIOB should be further clarified? Do you have specific suggestions regarding which areas this clarification should address?

Q16: Do you see merit in the PIOB undertaking a regular review of its due process and oversight framework through its strategy document?

Q17: Do you see merit in the PIOB periodically producing a strategy document that would supplement the yearly business plan and budget? What should the involvement of the MG be in the production of these documents?

ii) Composition

The PIOB's current composition is dependent on the appointments made by most of the organisations represented in the MG, although the FSB and the recently incorporated IFIAR does not appoint any member. Specifically, it includes nine nominees from regulatory and public interest organisations and one from IFAC (as the current rules require that one PIOB member have significant recent auditing experience in the private sector).

In practice it follows a principle of geographic and gender diversification and it reflects a balance of regulatory perspectives, which gives predominance to nominees from securities regulators, one of whom also becomes PIOB Chair following the rule established for the MG.

In principle, this composition does not pose any problem that differs substantially from those posed by the MG's composition, given the similarity between both, except for the issue that has already been considered within the section that referred to the composition of the MG.

Q18: Do you think that the current composition of the PIOB could be enhanced? Would you consider convenient that the PIOB's composition is reviewed each time a new body becomes a full member of the MG?

c. PIACs (and their respective CAGs)

i) Role

The current role of the three PIAC-standard setters is issuing international standards on audit and assurance, ethics and education for accountants. Specifically, the three Boards (IAASB, IESBA and IAESB) have this issuing task and their respective CAGs are designed to provide valuable inputs from all the relevant stakeholders with a legitimate interest in these areas.

There is no doubt about the need for a body or bodies that perform the structure's essential role since, without standards, nothing else makes sense.

So the real question here is about composition.

ii) Composition

IFAC has made sustained efforts in improving the independence and diversity of the composition of the PIACs since 2003, when the Reforms were approved. The MG has noted the challenges involved in setting the composition of international standard-setting Boards. There is the need to attract highly qualified Board member candidates while achieving an optimum mix of various skills, experiences and other attributes that bring not only the various forms of technical expertise but also the requisite public interest experiences.

Currently, the IAASB, the IESBA and the IAESB are composed of nine non-practitioners (i.e., not currently working in an audit firm) and nine practitioners. This equal composition was not a requirement of the Reforms as such and has contributed to a more diverse and independent composition of each of the groups of standard setters. In addition, the Chairs of the IAASB and the IAESB are non-practitioners. This is not the case for the Chair of the Ethics Board (IESBA), which is currently a practitioner. However, as aforementioned, IFAC has already made some steps in implementing the near term recommendation to achieve an independent position for chairing the IESBA, once the mandate of the current chair expires at the end 2012.

Focusing on their origin, only a minority of non-practitioner members of these Boards was suggested by organisations outside IFAC structure, which includes IFAC member bodies, (these members are called “public members”). IFAC has recently changed its constitutional arrangements in order not to limit the subsequent nomination process of some Board members to representatives from IFAC and the Forum of Firms, although some time is needed to elapse in order to assess how this will work in practice.

The effectiveness review report already provided for some measures intended to enhance the diversity and independence of the PIAC board members. As it has been previously mentioned one measure was the appointment of an independent IESBA chair. Other was to change the definition of non-practitioner thereby ensuring non-practitioner bring relevant experience outside the auditing profession. Currently non-practitioners could be employees of audit firm professional associations or can be retired practitioners whose financial situation may still be affected by the financial strength of an audit firm. IFAC is currently considering the best ways to implement them.

The MG thinks it needs to gain more experience before concluding that steps beyond those previously recommended could be necessary.

Nevertheless, the MG is consulting on some measures that could be considered in the future, at the time of the second effectiveness review.

In this regard, it might be advisable in the long run to assess whether it would be convenient to have a majority of non-practitioner members (i.e. more than 50% of the total Board members) nominated by organisations outside IFAC, in every Board and for the three Chairs to be non-practitioners.

Moreover, none of the three Chairs has been classified as a “public member” and this possibility should be considered. In particular, the MG is pleased to recognize the search process for an independent public member to chair the IESBA. It could be also noted that the current Chair of the IPSASB is a public member and the Chair of the IAASB is a non-practitioner with substantial experience outside audit firms.

The relevant arguments in favour of these proposals are to enhance the independence of the standard-setters board members and to avoid conflicts of interest. The drawback could be some loss of first-hand knowledge of current issues, especially in the IAASB, although this loss of expertise could be less relevant if a significant number of members are still practitioners. Furthermore, non-practitioner public member status should not be understood as meaning a lack of experience in auditing and practitioner status should not be understood as a lack of equal responsibility for serving the public interest in making decisions.

Regarding the CAGs, their composition is very wide and diverse. This diversity is appropriate in a consultative group that is expected to provide technical input to the standard setters and that can be an important source of information for the PIOB when judging whether the relevant opinions have been properly taken into account for issuing a standard.

CAG member organisations can remain CAG members indefinitely. Recently the PIOB has recommended that it is best practice that representatives of those organisations be renewed at least every nine years, leaving it up to member organisations to comply.

This principle is best practice according to the PIOB and aimed at bringing fresh viewpoints to the CAGs on a periodic basis. At the same time, it has been argued that organisations should have the legitimate right to appoint the person they consider to be

their best representative and that rotation could also cause some problems in small organisations that do not have many suitable candidates for that position.

Q19: Would you consider the current composition of the PIACs appropriate? Do you see merit, in the context of a second effectiveness review, in exploring the idea of having a majority of non-practitioners and a majority of public members?

Q20: Do you consider best practice a nine years period for rotation of the representatives of CAG member organisations?

Funding the structure

The current funding scheme of the IFAC structure is quite unusual as IFAC itself finances all the standard-setting activities and most of the public oversight but not monitoring functions.

It is worth noting that there is a big difference in funding approaches with respect to the schemes in place at the IASB and the IFRS Foundation in general. However, it does not seem realistic for the moment or in the near term to pursue a complete and radical change of this IFAC structure, as it was also acknowledged in the Effectiveness Review, and given the short timeframe that has happened since then, this conclusion can still be considered as valid.

The original 2003 Reforms agreed that an ideal funding formula would involve many parties. IFAC agreed to provide the funding in the early years while additional sources were sought. The MG effectiveness review report in 2010 recognized the need to explore additional opportunities for neutral and diversified PIOB funding so there is a means of assuring a continued flow of appropriate funding for the oversight function.

The current funding scheme for the PIOB is based on IFAC cash contributions (via a “blind trust”) that represent roughly 75-80% of the total budget. The EC earmarked a defined fixed contribution to the PIOB over the period 2010-2013. That contribution is conditional on achieving a more diversified PIOB funding.

The original IFAC contribution for the PIOB was 1.5 million USD with future adjustments for inflation and currency fluctuations. This arrangement is in place until 2015 and it stipulates that any amount received from other institutions will reduce the IFAC contribution. Afterwards, this amount was expressed in Euros (because the PIOB headquarters are in Madrid) and the total budget of the PIOB currently amounts to about 1.4 million Euros, of which approximately €300,000 are provided by the EC and the rest by IFAC.

It is worth noting there are some in-kind contributions. The most significant one is that provided by the Government of Spain through the Spanish Securities Regulator (CNMV), an IOSCO member, which provides the PIOB with office space free of charge and partly subsidises its facility operating costs. This contribution has been in place since the beginning of PIOB activities.

Other MG members, namely the BCBS (through the institution the representative works for) and the WB, are also making contributions in kind by waiving PIOB member stipends and travel reimbursements for their nominees, who are direct employees or representatives of those organisations.

In any case, as mentioned above, the European Commission requires that the PIOB's funding be further diversified as a pre-requisite for maintaining its current contribution over time.

This provides a good opportunity to undertake an analysis on how to expand the range of contributors, bearing in mind that excessive dependency on IFAC funding does not fit well with the concept that underlies the PIOB's task of overseeing the issuance of standards and its public interest role in the process.

In 2010, IFAC, PIOB and MG discussed exploring the possibility of aligning this process with that of the IASB funding process, which should in principle facilitate agreement on the PIOB since its budget is much smaller.

Nevertheless, major practical difficulties might make this unfeasible. While accounting standards have traditionally perceived as a public good that requires special financing, auditing standards have been more associated with services for which the private sector is already charged by audit firms, irrespective of its unquestionable public interest dimension. An argument that could be put forward is that public oversight of the auditing standard setting process could more reasonably be covered by public authorities themselves.

Another possibility was also contemplated in the IFAC Reform of 2003. Specifically, it said: "IFAC will seek contributions to cover 50% or more of the PIOB costs. Given the public interest nature of the oversight activities of the PIOB, the MG members may provide contributions to support the PIOB's activities. The PIOB may also be involved in seeking contributions to cover its costs."

This provision envisaged that IFAC and MG members could explore funding from external sources. It has been done in the past with mixed results but there could be some room for trying to revitalise this way of achieving funding. In fact, an IFAC leading task-force between IFAC, PIOB and MG has been recently created to perform an external PIOB budget fundraising program.

In the mid-term and until external fundraising have been performed, the most straightforward and feasible way to proceed might be to ask the member organisations of the MG to increase their total contribution to the PIOB funding beyond that provided by the European Commission and the aforementioned in-kind contributions by some members, as permitted by the member organisations' own rules.

Regarding the specific funding structure, ideally the target should be that at least 51% of the funds should come from sources other than IFAC.

Q21: Would you agree that it is not realistic at the current time to attempt to alter the funding structure of standard setting activities in any substantial fashion?

Q22: Do you consider appropriate that IFAC finances the largest part of the PIOB budget? If not, do you consider appropriate that IFAC launches an external fundraising having some contributions of the MG members in the mean time (until the fundraising is able to provide with some funds)?

Q23: Do you think it feasible to have a similar funding structure in place for the PIOB to that in place for funding the IFRS Foundation?

Also linked to the funding issue, it should be noted that the MG lacks a permanent staff structure. A permanent secretariat that is capable of providing practical experience and drafting work is a valuable asset for an organisation. Therefore, a permanent Secretariat for the MG would contribute to providing stability, efficiency and a better organisational framework to support the work of the group. It is not in the interest of the MG to continue depending on the resources provided by the incumbent Chair, especially as a change in the chairmanship of the MG is not infrequent.

A permanent Secretariat would also give continuity to the work and would facilitate the task of the new Chair and the rest of the members of the group when there is a change in the chairmanship.

There are a number of options for organising and financing a permanent secretariat. For example, it could be part of the PIOB secretariat or it could be financed through contributions from one or several members of the MG.

One possibility would be that IOSCO, as the organisation that appoints the Chair of the MG, provides the (mainly human) resources for maintaining the permanent Secretariat. This could be considered as an in-kind contribution to the funding of the PIOB and the oversight structure as a whole (see PIOB funding discussion).

Q24: Do you see the need for and/or merit in having a permanent Secretariat for the MG? In this case, do you think IOSCO should provide resources for a permanent Secretariat to the MG?

3. Final questions

The final aim of this paper is to propose some reflections and to request comments on whether further improvements are needed in the fields of auditing and assurance, ethics and education with the final goal of improving audit quality. In this sense, the document details the structure currently in place and also makes some questions asking for the adequacy of the current structure to the final goals. But, of course, respondents should be free to raise any ideas or suggestions that could be helpful to strengthen the current structure. In particular,

Q25: How do you think the governance of the international auditing, ethics and education standards setting process could improve audit quality? What are the main objectives that those responsible for governance should take into account?

Q26: What is your opinion about the current structure? Do you think the current structure is appropriate in order to improve audit quality? If not, what changes, suggestions or remarks would you propose?

Q27: Do you agree that the current levels of empowerment and responsibility of the bodies that compose the current structure (MG, PIOB and PIACs) are appropriate? If so, do you have any suggestions for improving the dialogue and interaction between the different bodies? If not, how these levels of empowerment and responsibility could be improved?

Q28: Do you think that there is any other overall structure that could achieve improvement in audit quality more efficiently? If so, what could they be and how might they be financed?

Appendix 1: Current international standard-setting structure in the fields of auditing and assurance, ethics and education

INTRODUCTION

This section outlines the rationale for the arrangements put in place for setting international standards for auditing and assurance, ethics and accounting education; arrangements in which responsibility is shared between the public sector and the private sector.

In 2010 the Monitoring Group (MG) completed an effectiveness review of oversight arrangements that had operated since 2005. The review noted that virtually all of the changes proposed in the IFAC Reforms (see below) had been implemented, and recognized the numerous achievements with respect to their implementation. All participants in the international standard-setting arrangements recognize that standard-setting in the public interest is a challenge that requires ongoing continuous improvement.

2000-2002: significant enhancements made to the transparency of the due process of standard-setting boards. Also, the title was changed from International Auditing Practices Committee (IAPC) to International Auditing and Assurance Standards Board (IAASB). Similar enhancements were later put in place, and changes of title made, for the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB).

2002-2005: the “IFAC Reforms” (sometimes referred to as the “2003 Reforms”), centred on enhancing the governance arrangements of the international standard-setting boards, were developed and implemented from 2003, with the PIOB commencing 2005. These arrangements included the establishment of the MG, PIOB and CAGs to strengthen the standard-setting processes in the public interest. As well as implementing the reforms outlined in the terms of the agreement between IFAC and key stakeholders, IFAC introduced additional reforms that were consistent with the overall objective of enhancing governance arrangements.

2005-continuing: international standard-setting boards operating under the reformed governance and oversight arrangements.

2010-2011: MG review identified a number of near-term actions for IFAC and the standard-setting boards it supports focused on further enhancing diversity, transparency, and accountability. IFAC and the MG agreed on the implementation of the recommendations made in the MG review.

OBJECTIVES IN DESIGNING THE ARRANGEMENTS FOR SHARED RESPONSIBILITY FOR INTERNATIONAL STANDARD SETTING

There are three key aspects of the arrangements for the system for international standard setting:

- First, the overriding objective in the design of the standard setting process is to help ensure that the institutional arrangements are, and are seen to be, properly responsive to the public interest at a global level.
- Second, a key issue for the public interest is the legitimacy and independence of the standard setting process, in order to increase public confidence in the standard setting arrangements and, ultimately, to strengthen financial reporting. Key elements of the arrangements to increase legitimacy and independence are an external process for monitoring and oversight of standard setting, and increased transparency.
- Third, it is important to maintain the technical competence of the standard setting process while ensuring that there is a sufficiently strong element of public oversight to achieve the first two objectives above.

PIOB

The PIOB has oversight of critical elements of the standard setting processes, including:

- The Nominating Committee's process for selection of the members and Chairs of the standard setting boards, whose appointments must be approved by the PIOB.
- Terms of Reference for the standard setting boards, which must be approved by the PIOB.
- Evaluating due process in relation to standard setting, which must be approved by the PIOB.

- Compliance with due process having been followed for each new standard, with PIOB sign-off before the standard can be issued.
- Completeness of the Board's strategies and work programs.

Representation on Standard-Setting Boards – Geographic or Regional

The system for international standard setting is designed to facilitate participation from nations at different stages of economic development and across diverse cultures.

In 2006, the IFAC Nominating Committee established a regional classification system that organizes its member bodies into six geographical areas: Africa/Middle East, Asia, Australasia/Oceania, Europe, Latin America and the Caribbean, and North America. In order to maintain geographical balance, the committee seeks to appoint individuals from each area on the standard setting boards.

IFAC has also established a program to subsidize the travel expenses of members from developing nations on all its boards and committees. This measure aims to improve participation in the standard setting process from countries in the developing world.

Due Process of Standard-Setting Boards

Each of the standard setting boards has a formal due process, approved by the PIOB. The due process for each board covers, inter alia, project proposals, issues papers, consultation papers (where appropriate), exposure drafts (with sufficient comment period), comment letters posted to the website, final standards being approved only after extensive consideration of comments, and a stated basis for conclusions.

Before any standard is issued, the PIOB must approve that due process has been followed, based on a declaration from the Executive Director – Professional Standards and from its own observations, dialogues, internal reviews and deliberations, etc.

The PIOB has the right, which it exercises, to observe meetings of the standard setting boards.

The standard setting process is highly transparent, with the meetings open to the public, the full package of agenda materials available to the public before meetings and minutes available after meetings.

Consultative Advisory Group

The CAGs are a key element of the standard setting arrangements. They enable the standard setting boards to receive technical advice, as well as advice regarding agendas, from interested external public sector and private sector institutions. Features of the CAGs are the following:

- The CAG elects its own Chair.
- The Chair of the CAG is an Observer to the standard setting board with the right of the floor.
- The CAG can appoint a member to sit on the Steering Committee of the standard setting board.
- The CAG has the power to hear and to reach conclusions on matters relating to the due process affecting its own recommendations and advice to a standard setting board and can, if it thinks appropriate, refer any concerns to the PIOB

Resourcing the Standard-Setting Boards

Resourcing is provided by way of funding from IFAC, IFAC member bodies and the Forum of Firms plus volunteer resources from a range of sources, including member bodies, firms, regulatory organisations and others. The PIOB is responsible for evaluating the adequacy of funding provided to support the standard-setting boards.

Transparency

Transparency is central to the functioning of the standard setting boards, and is reflected in many elements of the structure and process of the standard setting boards, including as discussed above under the heading “Due process of standard setting boards.”

Nominations Process

IFAC develops the nomination process for each standard-setting board, including the make-up of such boards, the qualifications of members, the number of members, and the make-up of the IFAC Nominating Committee.

This process is approved by the PIOB, which also provides final approval of the chairs and other members of boards selected by the IFAC Nominating Committee. The PIOB has authority to finally approve or reject any or all proposed members of boards

for good cause, stating its reasons should it choose to reject one or more members. Also, the PIOB has authority to request the removal of the chair of any board for good cause, explaining its reasons for doing so, should it choose to invoke this authority.

Composition of Standard-Setting Boards

The composition of each of the standard setting boards is eighteen members, including the Chair (who in the case of the IAASB is full-time; and in the case of IESBA and IAESB is part-time)

In 2011, as part of the MG review, agreement was reached to change the practice of reserving seats on the IAASB, IESBA and IAESB for nominees of the FoF and IFAC member bodies. Relevant governance documents are in the process of being updated, and will have effect from 2013. From that time, any organisation or individual would be able to nominate candidates for all positions on the standard-setting boards.

All members of the standard-setting boards are unpaid, part-time members, except for the full-time paid Chair of the IAASB (and from 2013 the part-time paid Chair of the IESBA).

Half of the members of the standard setting boards (including the public members) are non-practitioners, based on a definition of “non-practitioner” initially agreed with the MG, although IFAC has committed to develop jointly with the PIOB a new definition as recommended in the effectiveness review.

While individuals classified as “non-practitioners” are not currently practicing within an audit practice firm, there is nevertheless an expectation that they will have the knowledge and experience to participate fully in the standard setting process.

This composition tries to achieve some balance in the combination of independence and technical competence and thereby helps ensure the standard setting boards to set standards that are in the public interest.

Receiving Stakeholder Input

The standard setting boards receive technical input in relation to specific standards and in relation to its work plan from comment letters that are submitted on its proposals and from a CAG, the members and chair of which are selected independently of the standard setting boards and IFAC, and who represent regulatory and other stakeholder organisations.

These help ensure that these multiple perspectives on technical issues are presented to the standard setting boards. The Boards also benefit from the timing of the CAG member input which occurs while the Board is developing a proposal, as well as in the comment letters.

Accountability of Boards and Board Members

The IAASB produces an annual report on its activities for the previous period. The other two standard setting boards report within the IFAC Annual Report. All Board members sign an annual declaration to act in the public interest.

The accountability of standard setting board members is through annual performance monitoring by the IFAC Nominating Committee, subject to PIOB oversight.

If it believes there is valid cause, the PIOB has authority to request IFAC to remove a member or Chair.

Internal Policies and Procedures

There are many means, structural and operational, through which IFAC has given effect to its role in the shared arrangements and has sought to put into practice the spirit as well as the letter of the shared system of responsibility for standard setting. The structural mechanisms include the following:

- IFAC's Constitution and Bylaws delineate the powers and roles of the IFAC Council and Board with respect to the standard setting boards and also confirm IFAC's obligations to the PIOB.
- IFAC has clearly defined the types of documents that the standard setting boards issue. These document types are followed to promote consistency and legitimacy. Examples include Standards, Good Practice Guidance and Exposure Drafts.
- The Terms of Reference for each of the standard setting boards provide a consistent articulation of the mission of each board, general meeting procedures, and rules.
- Roles and Responsibilities for Chairs of the standard setting boards are outlined in separate documents.
- All of the above documents plus agenda and meeting minutes are publicly available on the IFAC website.

- The standard setting boards utilize the same web based procedures (IFAC website) and protocols to disseminate exposure drafts, collect comments and publish documents.
- The annual Call for Nominations for IFAC Boards and Committees outlines the Nominating Committee’s targets for qualifications and regional and professional representation. Publication of this document promotes transparency and consistency in the nominations process.
- All Board members and technical advisors are required to sign an annual declaration that they will act in the public interest at all times. Their nominating organisations are also required to sign an annual declaration that they will not seek to influence their nominee.

Operational mechanisms include, amongst others, the internal culture of the organisation, which emphasizes the public interest, and the performance management system. These mechanisms link individual performance to the elements of the Strategic Plan, which itself reflects the public interest.

The final structure that was established by the IFAC Reform is shown in the diagram below:

