4 May 2011

Senior Technical Manager, Regulation & Public Policy
International Federation of Accountants
545 Fifth Avenue, 14th Floor
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Our Ref: 2011/JE/TCSC1/IFAC/49

Subject Line: Exposure Draft of IFAC Policy Position Paper #4, A Public Interest Framework for the Accountancy Profession

Dear Sir:

The International Organization of Securities Commissions Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the IFAC Policy Position Paper #4, A Public Interest Framework for the Accountancy Profession (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing and professional standards, other pronouncements and statements.

Members of SC 1 seek to further IOSCO’s mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

Within this letter we have organized our comments to begin with our overall input on the project and IFAC’s proposed definition of the term “public interest” for the purpose of its self-evaluation. Later in the letter we have included some other observations on the Consultation Paper that may be helpful regardless of how IFAC ultimately describes the term “public interest.”
General Comments

Project Objective

We believe it is desirable for IFAC to evaluate how its organizational mission, values and functional operations affect and are affected by public interest considerations. We believe this is desirable because IFAC is a global association of the accountancy profession which through its activities and association with the profession contributes to the work of the profession. By extension this work affects capital markets and investors.

To conduct its work we can appreciate the need for IFAC to have a definition or at least a working description of its concept of the term “public interest.” It is helpful and appropriate for IFAC to articulate and expose this for comment. This process should be helpful to IFAC in identifying how its activities and the work and standards of the accounting profession are affected by and can contribute to the public interest.

It is less clear to us, however, how IFAC’s eventual definition or description of the term “public interest” could be designed to equally guide decisions made in the work of “…policymakers, regulators, and business leaders…,” which IFAC cites in the Paper’s introduction as one of its goals, or guide decisions made by individual accountants. This is because all of these parties typically have different roles, responsibilities and challenges.

Proposed Criteria for the “Public Interest”

In the Paper IFAC states that: “The accountancy profession must be mindful of the wider economic, political, and cultural implications of the public interest.” The Paper then contains a proposed “public interest” framework consisting of three criteria, specifically:

“IFAC considers that for the accountancy profession, serving the public interest should be evaluated against three criteria. This enables us to assess whether or not (and the degree to which) any policy, action, process, or condition is in the public interest. These criteria are:

1. Consideration of costs and benefits for society as a whole
2. Adherence to democratic principles and processes
3. Respect for cultural and ethical diversity”
With this proposed framework IFAC has selected and presented a very broad sociological concept of “the public interest.” We can see that the three criteria are worthwhile values and beliefs that may be helpful in part to guide the work of IFAC. However, it is difficult to see how such a broad concept could provide a guide for assessing specific actions. More specifically, it is not easy to see how IFAC’s framework would provide an operational guide to assess whether particular policies, actions, processes, conditions or standards in which auditors have an interest are beneficial to various segments of the public, notably to investors and other stakeholders in the public capital markets.

In addition to articulating general principles and criteria, we think a framework needs to emphasize the importance of considering the specific facts and circumstances and context of whatever endeavors are being evaluated. Making only the three very broad general statements in this proposed framework, without including examples of how application may differ in a specific operational context, would seem to be insufficient to guide at least IFAC’s standard setting work. The following three examples may help to illustrate these concerns.

Regarding “consideration of costs and benefits for society as a whole”, one can readily construct an argument that accountants can contribute to the reduction in greenhouse gasses worldwide by developing standards and providing assurance on GHG emission reports; however, we believe that if standard setting and accountancy resources are limited, such a choice should not interfere with a primary responsibility for efforts associated with preparing and auditing financial statements for use in the capital markets.

Regarding “adherence to democratic principles and processes”, in a situation in which there are many interested parties offering views and opinions on a particular issue, it is not always true that decisions should be based upon a democratic principle such as “majority rule”; that is, selecting the choice that is supported by the largest number of persons and organizations who respond to the request for input.

Regarding “respect for cultural and ethical diversity”, this is a trait and social value that most would agree is desirable in guiding human behavior – but it is hard to imagine how being respectful of diversity could change a hard and controversial decision that needs to be made on a professional standard or regulatory requirement where different business views and market concerns exist among different stakeholders but public protection needs to prevail.
Challenges to Addressing the Proposed Criteria for the “Public Interest”

General

One challenge that IFAC may have from time to time in making decisions is determining the course of action it should take if the business and professional interests of IFAC as an association and the business and professional interests of the individuals and firms in the accounting profession are, or appear to be, in some conflict with those of other stakeholders in the capital markets. With this in mind we noted that the Paper begins with a sentence that states “all professional organizations must consider the notion of the public interest while seeking to advance the interest of the professions they serve.” This sentence may be read as implying that when the notion of the public interest is in opposition to a more specific interest of the accounting profession, there should be parity between the two. We believe that the IFAC Framework should do more to promote the idea by clearly stating that the auditing profession has been given a special charter to serve the public capital markets by virtue of securities regulators requiring the audits of financial statements, and that advancing the profession should never come at the expense of this public interest.

While the proposed Framework with appropriate revisions could provide guidelines that IFAC can use as it broadly considers the public interest when performing other functions such as developing accounting and educational standards, contributing to the development of the accounting profession and accounting capacity around the world, establishing membership criteria for its organization, accepting new members and carrying out other functions that IFAC believes will contribute to society as a whole as well as to the accounting profession, we believe the Paper should also contain a prominent and central section with a specific focus on the auditor’s role and obligations in the capital markets. It seems reasonable to include provisions to the effect that, at a minimum, an IFAC public interest framework should include specific coverage of criteria and actions relating to accounting, auditing and disclosures that are intended to provide direct benefit to the capital market segment of society.

Adherence to Democratic Principles and Processes

In the Paper’s discussion of “Adherence to democratic principles and processes”, IFAC places high emphasis on procedures, structure and due process, steps and mechanisms. IFAC states that “by adhering to democratic principles as a public interest criterion, legitimacy and public confidence in the accountancy profession are protected.” While all the factors mentioned in the discussion of this criterion are important contributors to legitimacy and public confidence, in the end, it is the quality of the decisions made and of the output produced that is most critically important in achieving public
confidence. It is of little value to point to an extensive process of following prescribed steps and due process procedures if there is a significant quality and public interest problem with the output. We believe that IFAC’s discussion needs to address the factors relating to quality of decisions and output. We encourage IFAC to seek further input from stakeholders and provide coverage of the qualities and specific characteristics of decisions and output that may be deemed to serve the public interest.

Respect for Cultural and Ethical Diversity

The notion of “Respect for cultural and ethical diversity” introduces so many thoughts relating to history, ideology, trade and economics, law, ethnic and religious beliefs and business customs that we have difficulty seeing how it could be applied operationally in most recurring actions and decisions that would be made by IFAC. We agree that respect for cultural and ethical diversity is a laudable social value that should guide the behavior of human beings on a broad level, but we have trouble making the direct connection to how this can be used in assessing the public interest aspect of decisions of accountants and accounting and auditing and ethics standard setters.

Other Observations

Since there are multiple ways in which a public interest framework could be defined, our approach in providing our remaining comments is to concentrate on how the public interest framework may be considered by IFAC as it relates to its auditing and ethics standard-setting activities and other matters which affect the public capital markets.

Responsibilities of Professional Accountants

Under the sub-heading “What are its ‘interests’”, IFAC extended its definition of “interests” to describe very broadly the responsibilities that professional accountants have to society. The examples provided include several points upon which we agree the professional accountant shares responsibility. For example, we agree that requiring that accounting professionals apply high standards of ethical behavior and professional judgment should be a responsibility of the professional accountant. Further, we agree that professional accountants have a responsibility for providing sound financial and business reporting to stakeholders, investors, and all parties in the marketplace directly and indirectly affected by that reporting. However, we believe that it is important to have some focused and specific examples added to the list such as:

1. Provide high quality audit and assurance services, including audits of financial statements, to the marketplace to promote investor confidence in the integrity of securities markets; and
2. Develop and report financial information accurately and completely and objectively to provide transparency to users of financial statements.

Consideration of Costs and Benefits for Society as a Whole

We believe the distinction made between cost-benefit analyses and post-implementation reviews is arbitrary and not necessarily clear with respect to any unique concepts that would cause the two to be different. We believe that cost-benefit analysis is a continuing process and not simply a one-time exercise. It is not just a mechanism for checking whether the estimates were right at the policymaking stage but it should be revisited periodically over time. Over a period of time, different factors may influence the premium society places on a benefit as compared to the associated costs.

In addition, in the second paragraph under the heading “The 1st Criterion” the Paper states that “it is feasible for an action to have a positive net benefit for a company, while it has a net cost to society as a whole.” As the title of the Paper focuses on a public interest framework for the accountancy profession, it seems reasonable to expect that the foregoing sentence should include a mention of accounting firms as well as the mention of companies. If retained, we believe the sentence should be reworded to state “it is feasible for an action to have a positive net benefit for an accounting firm or company, while it has a net cost to society as a whole.”

Independence in Fact and Appearance

Under the sub-heading “Independence” the Paper states that all individuals should act independent from personal interests. We believe that, consistent with regulatory and ethical standards governing the accounting profession’s independence requirements, standard-setters should also exhibit independence not only based on their actions but also in appearance. Further, we believe that independence should not be limited to personal interests of individuals but should also encompass other interests such as business interests of accounting firms.

Use of Definitive Statements

We observed a number of instances in which definitive statements were used in the Paper to predict a certain outcome. For example, under the sub-heading “Fair and Balanced Representation in decision-making” the Paper states that:

“In addition to all regulatory, standard-setting and public oversight bodies being independent, there should also be the assurance that such bodies are comprised of
individuals that represent a full, balanced range of stakeholders or constituencies of the public. This can be guaranteed by a predetermined allocation of seats (and their respective votes) based on factors such as professional specialization, gender, or geographical region. This also includes mandating a balance between technical and non-technical representatives; the latter’s presence ensuring wider public participation.” (Italics ours).

In our view, it is highly improbable or impossible to predict with absolute certainty the outcomes noted above. As such, we believe it may be more appropriate to temper such definitive statements with more measured and supportable language. For example, in the paragraph quoted above, the words “guaranteed” and “ensuring” may be replaced by “promoted” and “facilitating”, respectively.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss the matters noted in this letter, please contact either Nigel James or me at 202-551-5300.

Yours sincerely,

Julie A. Erhardt
Chair
Standing Committee No. 1
International Organization of Securities Commissions