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# Review of the IFAC Reforms – Final Report

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The Monitoring  
Group

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## Introduction

The International Federation of Accountants Reforms (the IFAC Reforms or the Reforms) were born out of the erosion of confidence that arose from the financial reporting and auditing problems that occurred in and around 2002. This erosion led the International Federation of Accountants (IFAC)<sup>1</sup> and a group of six regulatory and international financial public interest institutions (which subsequently became known as the Monitoring Group)<sup>2</sup> to in 2003 begin a dialogue regarding the importance of having high quality audits of financial statements and the need to restore and enhance public confidence in financial reporting and auditing. The result of this dialogue was the IFAC Reforms.<sup>3</sup>

The provisions of the IFAC Reforms described changes to the structure and processes for the standard-setting boards and committees within IFAC that develop standards for auditing, auditor independence, accountant ethics, accountant education, and so forth. The objective of the Reforms was to increase confidence that these activities were properly responsive to the public interest and would lead to the establishment of both high quality standards and practices in auditing and assurance. To this end the Reforms called for the Monitoring Group to perform an ex-post review of the implementation of the Reforms. The Monitoring Group began this review in 2009. This Report contains its conclusions.

The Appendix to this Report describes the assessment work that the Monitoring Group undertook in reaching its conclusions. In performing its review the Monitoring Group considered both the text of the Reforms as well as the aims that underlie those provisions. The aims of the Reforms were intended to foster:

- (i) Greater diversity, to provide more opportunities for the perspectives of those who work outside of the audit profession to be brought into the standard-setting work;

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<sup>1</sup> IFAC is a global association of the accountancy profession. IFAC's members are professional bodies from 124 countries. For further information about IFAC, see [www.ifac.org](http://www.ifac.org).

<sup>2</sup> The Monitoring Group is a consensus-based group of the regulatory and international public interest organizations responsible, *inter alia*, for monitoring the implementation of the Reforms. The members are the Basel Committee on Banking Supervision, the European Commission, the Financial Stability Board, the International Association of Insurance Supervisors, the International Organization of Securities Commissions (IOSCO) and the World Bank. The International Forum of Independent Audit Regulators (IFIAR) is an observer. The Monitoring Group is chaired by IOSCO. Further information about the Monitoring Group, including its Charter, is available at [www.iosco.org/monitoring\\_group/](http://www.iosco.org/monitoring_group/).

<sup>3</sup> The IFAC Reforms were set forth in a document approved by the IFAC Council in November 2003. The full text of the Reforms, including a diagram of the resulting organizations and relationships, is available at <http://press.ifac.org/news/2003/10/ifac-and-international-regulators-propose-reforms-to-strengthen-audit-quality>. For convenience, this diagram is also included in the Reference section of this Report.

- (ii) Enhanced transparency, to provide more and easier access for constituents to information about the standard-setting work; and
- (iii) Accountability, to provide a link between the standard-setting work and its oversight by a new public interest oversight body as well as monitoring by the Monitoring Group.

The Monitoring Group's conclusions as a result of its review are contained in the following section, and further described in the remainder of this Report.

## **The Monitoring Group's Conclusions**

As a result of its work to review the implementation of the Reforms, the Monitoring Group reached the following conclusions:

*Matters of Past Implementation:* Virtually all of the changes called for by the Reforms have been implemented.

*Matters for Near Term Action:* There are several near term matters that are within the context of the Reforms which would bring enhancements to the standard-setting, oversight and monitoring work and thus further the aims of the Reforms with respect to diversity, transparency and accountability.

*Matters for Longer Term Analysis:* There are two longer term matters that go beyond the context of the Reforms which the Monitoring Group will keep under review and consideration.

### ***Matters of Past Implementation***

In this Report the Monitoring Group notes the numerous achievements by IFAC, the standard-setting Boards, their Consultative Advisory Groups (CAGs) and the international Public Interest Oversight Board (PIOB) with respect to implementation of the Reforms. This Report also notes some Reform measures that were indirectly or partially implemented. The Monitoring Group recognizes and acknowledges, however, that the initial implementation of the Reforms has been a significant undertaking that has necessitated the use of judgment in setting priorities.

### ***Matters for Near Term Action and Longer Term Analysis***

The Monitoring Group believes there are several important areas for future improvements to further the aims of the Reforms. These improvements are important in ensuring that the culture, behaviors and interactions associated with the standard-setting processes consistently and continually give full attention

to public interest considerations. Strengthening the public interest in standard-setting is necessary to continuously carry out the respective responsibilities of IFAC, the standard-setting Boards and their CAGs, the PIOB and the Monitoring Group under the Reforms. Carrying out these responsibilities facilitates the continued pursuit of international auditing standards, by working to balance the actual and perceived conflicts of interest associated with doing so. Further, in the more recent environment of changing financial markets and regulation and heightened expectations for transparency and accountability to the public interest, improvements to international audit-related standard-setting would help to keep pace.

In considering future improvements, the Monitoring Group has identified both matters within the context of the Reforms and matters that go beyond the context of the Reforms, although all are in pursuit of their public interest aims. The Monitoring Group believes that those within the context of the Reforms are thus for near term action while the Monitoring Group will keep the following two longer term matters under review:

- a. Whether standard-setting Boards that operate within an accountant's professional membership organization can carry out the responsibilities that ultimately come with international standard-setting in the public interest.

The conflicts of interest—both actual and perceived—that are inherent to operating within a professional membership organization will vary among the three standard-setting Boards, but are particularly important in setting auditor ethics and independence standards because these standards have a significant effect on the operations and business models of the firms in which members of the auditing profession practice.

- b. Whether there could be potential synergies associated with the two accountability functions now present for international standards; namely, the Monitoring Group for international audit-related standards and the Monitoring Board for international financial reporting standards.

These two longer term matters are further discussed in a later section of this Report.

The near term improvements to further the aims of diversity, transparency and accountability are included below. A later section of the Report describes the basis for each.

*Diversity: Building the best standard-setting Boards*

The Monitoring Group recommends that:

1. IFAC should change the practice of reserving 15 out of the 18 seats in the Audit Board and Ethics Board for nominees of the Forum of Firms and IFAC member bodies so that the opportunity for a Board member appointment is more easily accessible to all qualified persons.
2. IFAC should evaluate the current time and financial commitments asked of Board members in relation to whether such commitments are feasible for a large enough and diverse enough pool of qualified non-practitioners who could realistically serve on the Boards.
3. IFAC should take a first step toward providing more independence to the work of the Ethics Board by providing it with an independent Chair position in view of the inherent conflicts of interest that particularly relate to the work of this Board.
4. IFAC should manage the Board member appointments such that a substantial number of the non-practitioners who serve on the Boards work outside of auditing-related organizations, including auditor professional associations, so that they bring other perspectives to the debates.
5. IFAC should make complete information about the backgrounds, qualifications and affiliations of Board members available on its website so that from this perspective regulators and external stakeholders could better decide the level of confidence they wish to place in the Board's work.

*Diversity: Handling Board member duties*

The Monitoring Group recommends that:

6. The Board Chairs should ensure that the involvement of Technical Advisors in the Board's work encompasses only advisory and support roles so that the Technical Advisors are not effectively carrying out the Board's work via their level of involvement in the Board's evaluation and decision making processes.
7. If the roles of Technical Advisors are significant in Task Forces or other Board-related work, then IFAC should make backgrounds and the nature and degree of the rights and responsibilities of Technical Advisors available on its website to provide transparency.
8. The Boards should develop processes or practices for identifying the issues raised by those who represent the public interest so that those issues can receive adequate attention in Board papers and Board member discussions.

9. The Boards should either discontinue proxy voting or limit it to truly exceptional cases so that Board members also carry out the voting aspect of the Board's deliberative work themselves.

*Transparency: Constituent input to the Boards and Board feedback to the constituents*

The Monitoring Group recommends that:

10. The Boards' procedures should ensure identification of the views of all stakeholder groups, with emphasis on the quality and public interest rationale of the points raised rather than on the number of responders.
11. As each project progresses the Boards should provide a summary of tentative decisions to-date on the IFAC website so there is a better opportunity for constituents to notice any concerns along the way and then reach out to the Boards in a timely fashion.
12. IFAC, in consultation with the Monitoring Group members, should put in place the arrangements called for in the Reforms for the Boards to provide direct feedback to an individual Monitoring Group member regarding its input to the Boards if it does not appear that the Boards will take up the input in a final Standard in the manner that the Monitoring Group member recommended.
13. The PIOB, IFAC and the CAG Chairs and CAG members should undertake further examination to provide for a shared understanding of the technical consultative and advisory role of the CAGs.

*Accountability: Arrangements for the oversight and monitoring work*

The Monitoring Group concluded that:

14. If the post-Reforms standard-setting processes are to sustain themselves, then the PIOB needs to be able to feel comfortable utilizing a risk-based approach to performing its oversight work, in place of a strategy of 100% observation of meetings.
15. The Monitoring Group and the PIOB will, in consultation with IFAC, explore additional opportunities for neutral PIOB funding so there is a means to assure a continued source of appropriate funding for the oversight function.
16. The Monitoring Group has asked the PIOB to review its use of budgetary resources and will consult with the PIOB to revisit any issues related to its structure, staffing, assessment of risks, or other matters that may impede ongoing enhancements. The Monitoring Group will

work within its PIOB budget review role in considering, along with the PIOB, all of these matters.

17. The Monitoring Group, in consultation with the PIOB, will clarify the roles and responsibilities of each so that there is a better strategic dialogue and structure for future mutual interaction.
18. The Monitoring Group will both improve and better communicate its approach to monitoring so that it can better engage with the PIOB, the Boards and their Chairs, IFAC and other relevant organizations.

The Monitoring Group intends to carefully review the implementation of these recommendations.

## **The Monitoring Group's Conclusions – Matters of Past Implementation**

The Monitoring Group's conclusion is that virtually all of the changes called for by the Reforms have been implemented. Implementing the Reforms involved changes to the composition and functioning of the Audit, Ethics and Education Boards,<sup>4</sup> a strengthening of the arrangements for their respective Consultative Advisory Groups (CAGs), and the creation in 2005 of the international Public Interest Oversight Board (PIOB)<sup>5</sup> to oversee the Board member appointments to and the standard-setting processes utilized by these Boards. The PIOB was also assigned to oversee IFAC's membership compliance program for adoption and implementation of its professional standards.<sup>6</sup> The members of the PIOB are appointed by the Monitoring Group, which is also responsible for the approval of the PIOB's budget and the monitoring of the PIOB's activities.

Implementing the changes called for by the Reforms took significant and sustained efforts by all those involved with the work of the standard-setting Boards and their oversight. The Monitoring Group is pleased to highlight many of these specific achievements in this Report. At the same time, the Monitoring Group acknowledges that the implementation of the Reforms has involved judgment and

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<sup>4</sup> The names of these three Boards are the International Auditing and Assurance Standards Board (Audit Board); the International Ethics Standards Board for Accountants (Ethics Board) and the International Accounting Education Standards Board (Education Board), respectively. Information about these three standard-setting boards is available at [www.ifac.org](http://www.ifac.org).

<sup>5</sup> Information about the PIOB is available at [www.ipiob.org](http://www.ipiob.org).

<sup>6</sup> The IFAC member compliance program is handled by IFAC's Compliance Advisory Panel. Information about the Panel is available at [www.ifac.org](http://www.ifac.org).



trade-offs in terms of both priorities and approach, resulting in indirect or partial implementation of some aspects of the Reforms.

In reaching its conclusions the Monitoring Group did not seek to, and thus did not, form judgments about either the quality of the standards produced during the assessment period or their appropriate use. These are matters for individual authorities to determine. As a matter of due course individual Monitoring Group members have offered and will continue to offer comments to the Boards as the standards are developed, and these members have at times also issued broader public statements.<sup>7</sup> The Monitoring Group also notes its own ongoing efforts to encourage the development of high quality international standards.

### ***Diversity***

There has been notable progress to achieve greater diversity among the voices involved in the standard-setting work of the Boards. These efforts include the increase in the number of the members of the Audit and Ethics Boards who presently do not work for audit firms; the broader base of stakeholder groups who participate as members of the CAGs; and the speaking rights for each CAG Chair at the respective Board meetings. The diversity among Board member backgrounds has also been enhanced by the appointment of a Chair for the Audit Board who brings both audit and regulatory experience, and the appointment of some new members to the Ethics Board who bring various backgrounds.

The Monitoring Group noted one Reform provision related to diversity that was not implemented as originally described in the Reforms. This involves adding a specialist in business ethics to the Ethics Board. This was, however, implemented indirectly through the appointment of individuals to the Ethics Board who have significant related academic and practical experience in ethics matters.

### ***Transparency***

Similarly, there has been notable progress in achieving greater transparency. These changes include opening Board and CAG meetings to public observation and the posting to the IFAC website of Board meeting papers, brief summaries of Board meeting decisions, and audiotapes of some meetings of the Audit Board.

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<sup>7</sup> See, for example, the Basel Committee's Paper: External audit quality and banking supervision, December 2008, available at <http://www.bis.org/publ/bcbs146.pdf> and IOSCO's "Statement on International Auditing Standards" dated 11 June 2009, available at <http://www.iosco.org/library/statements/pdf/statements-7.pdf>.

At the same time, the Monitoring Group noted one Reform provision related to transparency that was implemented indirectly. This involves the arrangements by which the standard-setting Boards provide feedback to individual Monitoring Group members with respect to any instances in which their respective comments on a proposal are not taken up in a final Standard. To this end the Audit and Ethics Boards have provided some discussion of the rationale for Board decisions within Board meeting papers and during CAG meeting discussions, but arrangements for direct feedback to a Monitoring Group member about its comments to the Audit and Ethics Boards have not been fully established.

### ***Accountability***

A central provision of the Reforms with respect to accountability was the institution of the PIOB. The PIOB was established as a body that is independent from the audit profession. It is composed of senior individuals who have broad experience in financial reporting and regulation of financial markets. The work of the PIOB has encompassed overseeing the standard-setting Board member appointment processes and Board deliberative due processes as well as oversight of activities associated with the growth in IFAC's member compliance program.

Under the Reforms the Monitoring Group was assigned the role of providing a forum within which its members could monitor both the overall operation of the Reforms and the PIOB's oversight work. In addition to selection of PIOB members and a review function associated with the PIOB budget, the Monitoring Group or its members carry this out by meeting with the PIOB Chair, some PIOB members and the PIOB Secretary General on matters of interest. The Monitoring Group also carries out a program of ongoing communications with the leadership of IFAC through the IFAC Regulatory Liaison Group.

The Monitoring Group noted one Reform provision related to the oversight process that was implemented indirectly. This provision involves the PIOB's evaluation of the adequacy of the funding provided to the three standard-setting Boards and to the Compliance Advisory Panel. The Boards now have resources beyond those that were available at the time of the Reforms; however, this area warrants explicit evaluation by the PIOB going forward.

### **The Monitoring Group's Conclusions – Matters for Near Term Action**

As part of its assessment the Monitoring Group considered the respective roles that IFAC, the standard-setting Boards, the PIOB and the Monitoring Group were given under the Reforms. In particular, IFAC and the standard-setting Boards have the responsibility to take the lead in supporting the aims of greater diversity and enhanced transparency while the PIOB and the Monitoring Group have their respective

responsibilities in taking the lead to support the aim of accountability. Fulfilling these responsibilities is not a static endeavor; rather, it calls upon all groups to continually assess and, if necessary, amend the safeguards and structures put in place to balance all the competing pressures such that the interests of the audit profession do not negatively affect setting standards that serve the public interest.

In evaluating what it learned from its assessment work the Monitoring Group has drawn upon the international public interest and regulatory experiences of its members to identify some recommendations for enhancements that would further support the aims of the Reforms. The resulting outcomes would further achieve reflecting public interest considerations within the environment of the Boards' deliberations. They are described below.

In considering both its near-term (and longer term) recommendations, the Monitoring Group focused on the work of the Audit and Ethics Boards. This is due both to the direct effect of the work of these Boards on the audits of financial statements and the legacy of the impetus for the Reforms. The Monitoring Group recognizes and acknowledges that the education of accountants and auditors is highly important in the long term development of competent professionals. The Monitoring Group appreciates the work that the Education Board does in this area. Further, the Monitoring Group did not consider the work of IFAC's member compliance program in forming its recommendations, despite IFAC's plans for continued emphasis on providing resources for these efforts. This is in part due to the less direct effect of the compliance efforts of IFAC member bodies on establishing auditing and ethical standards.

### ***Diversity***

The Monitoring Group notes 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. To further address these diversity challenges the Monitoring Group recommends that IFAC, in consultation with the PIOB as appropriate, take appropriate measures to achieve the outcomes described below.

### ***Building the Best Standard-Setting Boards***

Over the years IFAC has enhanced the public Call for Nominations that it uses to advertise Board member vacancies. However, despite this enhancement, certain traditions and practices can potentially act as a hindrance in achieving diversity and attracting "the best persons for the job" in order to build the best possible standard-setting Board. These are the traditions and practices that (1) require 15 of the 18

members of each Board to be identified through a nomination from either an IFAC member body or the Forum of Firms<sup>8</sup> and (2) call for a Board member to provide approximately 400 to 600 hours of work per year without financial compensation for the time involved.

With regard to the Board member nomination process, the current processes imply some exclusivity and an importance of having member body contacts and being able to navigate through the appointment processes of member body organizations. The Monitoring Group believes that these processes could preclude some qualified candidates from consideration due to their non-affiliation with member organizations. IFAC member bodies and the Forum of Firms are valuable sources for qualified Board members, but should not be given preferences in the form of gatekeeper roles in the selection process.

In the interest of most effectively achieving diversity and broad-based stakeholder participation in the standard-setting Boards, the Monitoring Group recommends that IFAC change its nominating procedure to change the constraints that reserve 15 out of the 18 seats in the Audit and Ethics Boards to the combination of IFAC member body and Forum of Firm nominees so that the opportunity for a Board member appointment is more easily accessible to all qualified persons.

With regard to the level of a Board member's commitment, the Monitoring Group notes that whether the Boards can attract a sufficiently diverse set of members depends upon the time and financial demands placed upon a part-time Board member as well as the interests of individuals in contributing to audit and ethics standard-setting. This may especially be the case for representatives of small and medium-sized enterprises ("SMEs") and small and medium-sized audit and assurance practitioners ("SMPs") and emerging market countries. They may bring valuable expertise to the standard-setting process but they may not have the necessary resources to participate under present circumstances.

In the interest of evaluating what type of commitment would be the most feasible for those outside the audit profession, the Monitoring Group recommends that IFAC determine whether there is a large enough and diverse enough pool of qualified non-practitioners who can realistically meet the current time and financial commitments asked of a Board member. Additionally, such consultation may help IFAC in determining if financial incentives are warranted to enable qualified individuals to participate who are not employed as audit professionals or are not otherwise compensated to participate as a Board member. From this work IFAC may also be able to identify possible sources to fill the Chair position of the Ethics

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<sup>8</sup> The Forum of Firms is an association of international networks of accounting firms that perform audits of financial statements that are or may be used across national borders. Further information about the Forum of Firms is available at [www.ifac.org](http://www.ifac.org).

Board with an individual who is independent of the audit profession. The Monitoring Group recommends that IFAC take this first step toward providing more independence to handle the inherent conflicts of interest in the Ethics Board's work by establishing an independent Chair position.

The implementation of the Reform provisions has brought about a balance of Board member backgrounds that achieves parity between two groups of Board members, those defined as "practitioners" (members currently employed in auditing) and "non-practitioners" (generally, members who have not been employed as auditors during the previous three years, but whose earlier careers might have been as an auditor). IFAC and the PIOB have also worked to increase diversity in both the Audit and Ethics Boards from other standpoints such as geography, nature of professional experience and other characteristics.

Balancing "practitioners" with "non-practitioners" has made progress toward more diverse Boards; however, application of these definitions in and of themselves does not achieve the best mix of skills, perspectives and incentives among the various Board members. For example, non-practitioners can 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.

The Monitoring Group recommends that a substantial number of the non-practitioners who serve on the Boards work outside of auditor-related organizations including auditor professional associations, in order to bring other perspectives to the debates. IFAC should also apply approaches that are unique to each of the three Boards since the risks that the particular outside affiliations bring to the work of each Board—in fact and in appearance—will differ among the Boards. In any event, complete information about Board members' backgrounds, qualifications and their other affiliations should also be made available on the IFAC website, as an enhancement to the brief facts provided today. Regulators and other external stakeholders could better decide the confidence they wish to place in the Board's work if they are able to see this information.

#### *Handling Board Member Duties*

The Monitoring Group recognizes that Technical Advisors bring important detailed technical expertise to the work of the Boards. However, it is important that Board members are selected on the basis of their personal ability to contribute to standard-setting work and therefore that the roles and degree of participation and resulting influence of the Technical Advisors are carefully defined and do not approach the roles of Board members. The Monitoring Group recommends that care be taken to see that the involvement of Technical Advisors remains in advisory and support roles so that they are not effectively carrying out the Board's work via their level of involvement in the Board's evaluation and decision

making processes. In addition, if Technical Advisors are significant participants in Board Task Forces or other Board-related work, there should be transparency via the IFAC website about their backgrounds and the nature and degree of the rights and responsibilities associated with their participation in this work.

Further, it is important that all Board members actively and fully participate in the deliberation and decision making related to Board activities. There is a need to complement the opportunities to influence Board decision making by Board members who provide technical expert inputs with opportunities for the Board members who bring other perspectives to also have an effect. Thus the questions of Board composition and Board process are closely linked. The Monitoring Group recommends the Boards' develop processes or practices for identifying the issues raised by those who represent the public interest, so that those issues can receive adequate attention in Board papers and Board member discussions.

A final dimension of a Board member's personal ability to contribute to the standard-setting work is the ultimate test; when he or she casts their vote. This objective is compromised, at least in appearance, through the use of proxy voting for Board members. Accordingly, the Monitoring Group recommends that the Boards either discontinue proxy voting or limit it to truly exceptional cases so that Board members also carry out this aspect of the Board's deliberative work themselves.

### ***Transparency***

The Monitoring Group's recommendations related to transparency focus on how constituent perspectives and insights and comments on proposed standards are brought to and characterized for Board members and on how the Boards' reactions and decisions are explained to and made available to constituents. The Monitoring Group notes that since the Reform's procedural changes were implemented the Boards have continued to implement a number of improvements that have had a positive effect on the transparency of Board protocols and processes. The Monitoring Group observes, however, that there are opportunities for ongoing improvements to further enhance transparency. The Monitoring Group recommends that IFAC and the Boards, in consultation with the PIOB as appropriate, take the appropriate measures to achieve the outcomes described below.

### ***Constituent Input to the Work of the Boards***

The Boards' standard-setting processes provide a variety of opportunities for input from constituents. The long-standing practices are to issue a proposal on which input is solicited via written comment letter and to raise issues for discussion at CAG meetings. An example of a more recent practice by which the Boards promote information sharing and understanding of technical issues earlier in the life cycle of a

project is education sessions at Board meetings that are led by outside presenters who address topics relevant to a Board project. The Monitoring Group believes that all of these approaches are helpful and complementary, although the written comment letters should have primacy in that these letters are the most complete source of a constituent's views because they are arrived at after due process. In evaluating the input received; however, the Monitoring Group notes that it is important that the merits and public interest perspective of an argument carry greater weight than the frequency with which a point is raised. The Monitoring Group recommends that the procedures of the Boards ensure identification of the views of all stakeholder groups, with emphasis on the quality and public interest rationale of the points raised rather than on the number of responders.

#### *Board Feedback about its Work to Constituents*

The Boards' efforts to make their deliberations and decisions more accessible to all constituents have increased the ability of constituents to follow and understand the Boards' efforts; however, opportunities exist for further improvement. This is important because transparency of the process can be, or at least appear, compromised if the reasons for the decisions taken during deliberation of a proposal or a final standard are unclear to outside stakeholders. The Monitoring Group recommends that as each project progresses the Boards' provide a summary of tentative decisions to-date on the IFAC website. Such decision summaries would create a better opportunity for constituents to notice any concerns along the way and then reach out to the Boards in a timely fashion.

Further, as noted earlier, the Reforms called for the Boards to give direct feedback to Monitoring Group members in the form of explanations if their comments on a proposed Standard were not taken up in a final Standard. This provision stems from the fact that Monitoring Group member organizations have roles that give them responsibilities associated with the public interest. Because such feedback has not been regularly provided to Monitoring Group members, the appropriate arrangements need to be put in place for doing so. This step should then be part of the standard-setting processes overseen by the PIOB.

#### *Constituent Input and Board Feedback via the Boards' Consultative Advisory Groups*

Over the years the CAG Chairs and CAG members have diligently contributed technical input and other advisory input to the Boards. The Monitoring Group recognizes and appreciates the significant efforts involved. At the same time, the Monitoring Group observes that on occasion different understandings and perceptions have appeared to exist among IFAC, the PIOB, CAG members and the Monitoring Group regarding the role of the CAGs. While the Reforms would suggest and the CAG members have stated that they view their role solely as providing advisory input, references by IFAC and the PIOB sometimes

appear to ascribe to the CAG a greater technical review role; one of providing a technical check within the standard-setting process or even providing a component of oversight. The appearance of a technical review role arises in part from the volume of reading materials sent to CAG members, the questions asked of CAG members in the CAG meetings, and reports in Board meetings that CAG members did not raise any issues with a standards proposal. While it may be the intent that the CAG reading materials are for background purposes only, during the CAG meeting CAG members are often asked to give views on the technical correctness of proposals described and on the completeness of issues to be addressed.

A technical review by the CAGs goes beyond what can realistically be provided by a consultative advisory group composed of broad-based stakeholders who meet two or three times a year. Further, such explanations and statements could lead to misconceptions of what actually occurs in the standard-setting processes. It is important that a clear distinction be made between the roles of advisory input to standard-setting processes, management of the technical work of developing standards, and public interest oversight of the due processes utilized by the Boards. Such a distinction is important to both effective function and accurate transparency. Accordingly, the Monitoring Group recommends additional examination should take place among the PIOB, IFAC and the CAG Chairs and CAG members to provide for a shared understanding of the technical consultative and advisory role of the CAGs. This advisory role should then guide the refinement of meeting procedures, agendas and agenda materials.

### ***Accountability***

The Monitoring Group's following recommendations relate to accountability. They address the PIOB's oversight of the Boards' work, the Monitoring Group's interaction with the PIOB, and the Monitoring Group's overall monitoring of the Reforms. The central issue the Monitoring Group identified is the way in which the PIOB and the Monitoring Group can individually structure their operations to be more efficient and effective, as well as the arrangements for the interaction between them. Some aspects of what the Monitoring Group foresees that this will entail are described below.

### ***Arrangements for the Oversight Work***

The role and work of the PIOB has been important to implementing the provisions of the Reforms. During this time PIOB resources were devoted to its members' direct observation of all Board and CAG meetings, following from the PIOB's judgment of how best to conduct the oversight work at the time. Nevertheless, if the post-Reforms standard-setting processes are to sustain themselves, then the PIOB needs to be able to feel comfortable utilizing a risk-based approach to performing its oversight work. This is in place of a strategy of 100% observation of meetings. Under a risk-based approach the PIOB is



still conducting oversight but in a manner that appears more at arm's-length from the operating activities of the Boards. Implementing a risk-based approach would involve evaluating the importance of a standard-setting related meeting, its nature (e.g., technical, strategic) and how attendance by the PIOB would mitigate risks in serving the public interest.

The PIOB's activities are funded largely by IFAC in a "blind trust" type arrangement agreed by IFAC and supervised by the Monitoring Group. Under this arrangement IFAC does not have a role in deciding whether and how the PIOB spends its annual funding. Nevertheless, a significant issue for the PIOB, and for the Monitoring Group and IFAC, is finding a means to assure a continued neutral source of appropriate funding for the oversight function. An important step in that direction is the decision of the European Commission to contribute 1.2 million Euros to the PIOB's funding for the period 2010-2013. In terms of further steps, the Monitoring Group and the PIOB will, in consultation with IFAC, explore additional opportunities for continued sources of neutral PIOB funding for the oversight function. A precursor to determining sources of funding is a fresh indication of the amounts needed, and their timing, in view of an efficient and effective use of resources. The Monitoring Group has asked the PIOB to review its use of budgetary resources and will consult with the PIOB to revisit any issues related to its structure, staffing, assessment of risks, or other matters that may impede ongoing enhancements. These items can in turn be affected by assumptions about structure, oversight approach, related operating style, and so forth. The Monitoring Group will work within its PIOB budget review role in considering, along with the PIOB, all of these matters.

#### *Interaction between the Public Interest Oversight Board and the Monitoring Group*

In the five years since the PIOB's establishment in 2005, the Monitoring Group has sought to let it "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 established its form of operation and made a public report of its activities each year. The Monitoring Group 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. Beyond these links, the Monitoring Group will consult with the PIOB members to clarify the roles and responsibilities of each so that there is a better structure for strategic dialogue and future mutual interaction. The Monitoring Group anticipates that this will highlight the PIOB's mandate to provide oversight to the standard-setting due process, including Board member nominations. It will at the same time emphasize the role of the Monitoring Group to monitor the entire process.

### *Arrangements for the Monitoring Work*

The way the Monitoring Group has organized itself to operate and to engage in a distinct and complementary manner with the PIOB and others can be improved and be made clearer to those outside its membership. Accordingly, the Monitoring Group will both improve and better communicate its approach to monitoring so that it can better engage with the PIOB, the Boards and their Chairs, IFAC and other relevant organizations. To this end the Monitoring Group anticipates an initial step of making practical improvements as a result of reviewing its operations.

## **The Monitoring Group's Conclusions – Matters for Longer Term Analysis**

The Monitoring Group's assessment work also encompassed discussions about several longer term issues. The Monitoring Group raised these matters in its Consultation Paper, or they arose in the Monitoring Group members' discussions, or both, but the Monitoring Group considers it premature to reach decisions on them at this time. These matters are described below. Further, the Monitoring Group intends to carefully review the implementation of the near term recommendations flowing from this Report and conduct future reviews of any aspects of the Reforms when and if needed.

### ***Diversity and Transparency***

#### *Standard-Setting within a Professional Membership Organization*

The Monitoring Group will keep under review whether standard-setting Boards that operate within an accountant's professional membership organization can carry out the responsibilities that ultimately come with international standard-setting in the public interest. At the time of the Reforms the continued use of the standard-setting Boards which operated within IFAC was a practical constraint because this made it possible to introduce standard-setting process enhancements more rapidly than would otherwise be the case. However, a professional membership organization understandably brings a culture having considerable emphasis on the concerns of its member bodies and persons practicing within the profession. It is a significant challenge to take into account the need for technical expertise while at the same time ensuring that the public interest is served and simultaneously address the needs of the membership of an organization. A further challenge involves taking into account the importance of setting standards that are appropriate for listed companies as well as for other entities of public interest, including for the environments of SMEs and SMPs.

The matter for consideration by the Monitoring Group is whether in meeting these challenges the work of the Boards can be adequately "safeguarded" from a tradition of membership emphasis such that all

standard-setting work is performed objectively in the public interest. And it is not evident that safeguards which may be appropriate for one standard-setting Board are adequate for the differing work of another. The Monitoring Group observes that the risks inherent in the work of the Ethics Board, in which the basic business models and commercial interests of audit firms are at stake when the auditor independence and other matters are deliberated, seem greater than for the Audit Board yet it is the Audit Board that currently has the greater safeguard in place in the form of an independent Chair position.

## ***Accountability***

### *Multiple Standards Associated with International Financial Reporting*

The Monitoring Group will also keep under review whether there could be potential synergies associated with the two accountability functions now present for international standards; namely, the Monitoring Group for international audit-related standards and the Monitoring Board for international financial reporting standards.<sup>9</sup> The Monitoring Board is currently carrying out an unrelated review to assess governance matters associated with the IFRS Foundation.<sup>10</sup> The completion of this work will give the Monitoring Group the opportunity to examine how the two monitoring functions compare for the future, and what could be considered to achieve any available synergies.

Also, as part of its assessment work the Monitoring Group had a discussion with the Chair of another IFAC sponsored standard-setting Board, the International Public Sector Accounting Standards Board. This Board develops international accounting standards that are intended for use by governmental and other public sector enterprises. The Monitoring Group's discussion occurred to follow-up on the fact that under the provisions of the Reforms the PIOB does not assume an oversight role for this Board. The Monitoring Group has discussed this but has not taken onto its agenda the matter of revisiting this scope provision of the Reforms.

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<sup>9</sup> Further information about the Monitoring Board is available at [www.iosco.org/monitoring\\_board/](http://www.iosco.org/monitoring_board/).

<sup>10</sup> Further information about the governance review is also available at [www.iosco.org/monitoring\\_board/](http://www.iosco.org/monitoring_board/) while further information about the IFRS Foundation is available at [www.ifrs.org](http://www.ifrs.org).

## **Appendix – The Monitoring Group’s Assessment Work**

The Monitoring Group’s assessment work covered the following broad areas of inquiry:

- (i) Whether the provisions of the Reforms were in fact implemented; and
- (ii) Whether there are additional actions that could further support the aims of the Reforms.

Pursuant to these areas of inquiry, the Monitoring Group’s assessment work encompassed the following:

As part of the Monitoring Group’s and its members’ routine work over the past five years -

- Observation of the standard-setting work of the Audit and Ethics Boards through:
  - Membership in the Boards’ CAGs;
  - Participation in the Boards’ roundtables and working groups;
  - Periodic attendance among the public audience at Board meetings; and
  - Submission of comment letters on Board proposals.
- Discussion of the PIOB’s activities with its Chairman, some Members and its Secretary General.
- Discussion of current auditor oversight matters with the members of IFIAR.
- Discussion of current matters in the auditing profession with IFAC’s Regulatory Liaison Group.

Additionally, as part of the Monitoring Group’s incremental work associated with this review -

- Discussion of their respective activities with the Chairs of the Education Board, the IFAC Compliance Advisory Panel and IFAC’s International Public Sector Accounting Standards Board.
- Discussion of this review with the members of the PIOB and with representatives of IFAC, including review of their respective self-assessments on implementing the Reforms.
- Discussion of this review with the Chairs of the Audit and Ethics Boards, the members of each Board’s CAG, and the members of IFIAR.
- Solicitation of feedback on the validity of its preliminary views via a public Consultation Paper, and evaluation of the input contained in the 35 comment letters received.<sup>11</sup>
- Review of the matters in this Report within and among Monitoring Group member organizations, including the requisite due diligence procedures associated with issuing this Report.

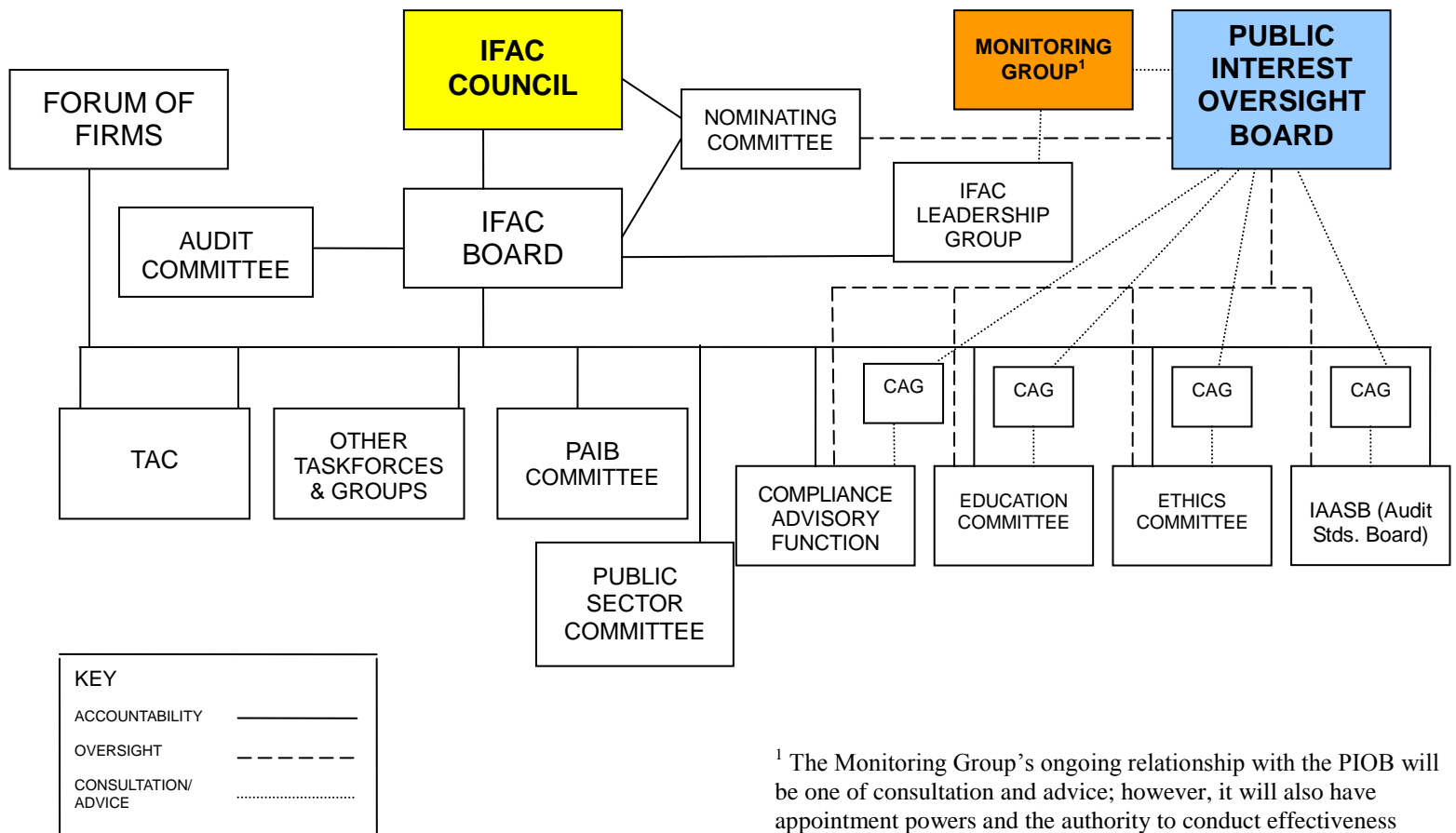
The Monitoring Group acknowledges and expresses its sincere appreciation for the significant efforts made by all the parties who provided input and perspectives into the work of carrying out its review.

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<sup>11</sup>The comment letters received on the Consultation Paper, accompanied by a summary of their contents, are available at [www.iosco.org/monitoring\\_group/](http://www.iosco.org/monitoring_group/).

## Reference Material

### IFAC Organizational Structure as a Result of the Reforms



Source: IFAC Reforms

<sup>1</sup> The Monitoring Group's ongoing relationship with the PIOB will be one of consultation and advice; however, it will also have appointment powers and the authority to conduct effectiveness reviews).

## Reference Material

### Acronyms Used in this Report

<u>Acronym</u>	<u>Full Title</u>
Audit Board	International Audit and Assurance Standards Board
CAG	Consultative Advisory Group
Education Board	International Accounting Education Standards Board
Ethics Board	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFAC Reforms; the Reforms	2003 International Federation of Accountants Reforms
IFIAR	International Forum of Independent Audit Regulators
IOSCO	International Organization of Securities Commissions
PIOB	Public Interest Oversight Board
SMEs	Small and medium-sized enterprises
SMPs	Small and medium-sized audit and assurance practitioners