

SECOND PUBLIC REPORT
OF THE
PIOB
MAY 2007



Public Interest Oversight Board

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

Launched on March 1, 2005, the Public Interest Oversight Board (PIOB) is a global body jointly created and sponsored by the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), The World Bank, the European Commission, and with the collaboration of the International Federation of Accountants (IFAC).

The PIOB's mandate states:

“The objective of the PIOB is to increase the confidence of investors and others that the public interest activities of IFAC (including the setting of standards by IFAC boards and committees) are properly responsive to the public interest.”

¹ The IFAC reforms constituted a set of changes, agreed with the international regulatory community, of IFAC structures and processes to enhance the transparency and rigor of its standard-setting processes and to establish the PIOB. For further information, please refer to the IFAC Reform Proposals document available at

In fulfillment of this mandate, and as part of a broader program of IFAC reforms¹, the PIOB engages in active oversight of designated IFAC-sponsored public interest activities.

The sponsoring organizations have established a forum known as The Monitoring Group to promote cohesive dialogue on implementation of the IFAC reform program. The PIOB also operates with the support of the Financial Stability Forum² (FSF).

The PIOB is headquartered in Madrid and conducts its operations from within the legal structure of a Spanish non-for-profit Foundation. Appendices A through C set out further information concerning the PIOB's operating environment, its structure and its sponsors.

http://www.ifac.org/Downloads/IFAC_Reform_Proposals.pdf


² The Financial Stability Forum seeks to co-ordinate the efforts of various national and international regulatory bodies in order to promote international financial stability, improve the functioning of markets and reduce systemic risk.



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SECOND PUBLIC REPORT
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Message from the PIOB Chairman

Stavros Thomadakis
Chairman



The Public Interest Oversight Board has completed its second year of oversight and I am happy to present the corresponding Second Public Report. Through a host of activities and decisions, the Board has gained considerable momentum and established its independence and authority in the international activities of standard setting and compliance conducted under the auspices of the International Federation of Accountants.

The Board has operated with a high level of collegiality and has achieved increased effectiveness. Its administrative function has stabilized thanks to the efficient services of the Secretary General. Its perspective has been enriched through the support of the European Commission and the Commission's designated observers. It has worked very diligently to attain a more refined, and also more demanding, understanding of the international public interest. It has also gone to great lengths to provide formal policy and informal guidance to the bodies under its oversight and to those undertaking the nominations process for appointment to these bodies.

Oversight of international standard setting is a complex task. It requires not only an internal focus on the standard-setting activities themselves but also an external one: the perceptions, expectations and priorities of potential users of standards around the world, including investors, practitioners and regulators. During its second year the PIOB has continued to organize and refine its method of weaving together the internal and the external focus in a way that can best ensure the high quality and applicability of standards produced under its oversight.

An important condition for global acceptance of standards is the credibility of the standard setters and the standard-setting process. We have fully realized that a multiplicity of dialogues and perspectives must be coordinated in order to achieve credibility, international comparability and ultimately convergence. Our part of the task refers only to standard setting but the project in its totality also involves those stakeholders charged with implementation and quality control. We stand ready to work with all whose mandates correlate with ours.

We are in the middle of a course that has already taken us a long way from where we began in March 2005. While we still have a distance to cover, the course we have charted promises to carry us forward to a high level of independent and effective international oversight. We remain committed to ensuring that world standards of audit, ethics and accounting education will be underpinned by the public interest and will thus deserve to be adopted by the global community.

Second Annual Report

I. INTRODUCTION

The Public Interest Oversight Board (PIOB) has now concluded its second year of oversight activities.

The PIOB's first year was devoted to several essential activities: initiation of public interest oversight for existing IFAC public interest activities, first policy actions and development of the first concrete definition of the international public interest applicable to setting standards¹ for the accounting profession. Given its primary objective, the PIOB moved quickly to develop and implement a comprehensive and active oversight program for three standard-setting boards² and their respective Consultative Advisory Groups (CAGs). The PIOB also gave high priority during this period to organization, startup and creation of a legal presence.

Full details of the PIOB's first year of operation, including its initial goals, activities and achievements, have been documented in the PIOB's First Public Report.

By the beginning of its second year the PIOB was in full operational mode and, in addition to monitoring, was able to focus its efforts on developing the policies needed to make the new international standard-setting architecture work. The PIOB also continued with its implementation of a suite of programs and activities designed to address the full scope of its mandate, including:

- direct dialogue with IFAC leadership on strategic issues involving the public interest (*see Section II of this report*);
- evaluation of due process before the final publication of international standards (*Section III*);

- oversight of the nominations process for membership appointments to the three standard-setting boards, the Compliance Advisory Panel (CAP) and the CAGs (*Section IV*);
- initiation of the process to review future work plans and priorities for the standard-setting boards (*Section V*);
- communication of the PIOB's activities and goals to the worldwide regulatory community and to accounting and auditing professional bodies (*Sections VI and VIII*);
- establishment of a collaborative relationship with the growing community of audit oversight authorities and their newly formed International Forum of Independent Audit Regulators (IFIAR) (*Section VII*); and
- further refinement of both the concept of the international public interest as it pertains to the PIOB's area of oversight and the corresponding practice of oversight consistent with this evolving concept (*Section IX*).

The PIOB believes that undertaking these programs and activities has contributed to achieving two important objectives:

- to further the PIOB's basic goal of increasing stakeholder confidence in the ability of IFAC public interest activity committees to be responsive to the public interest³; and
- to make this aspect of IFAC reforms workable and productive.

In October 2006, the European Commission announced that in due course its two appointed observers would be nominated for appointment as full members of the PIOB. This is an important and welcome step toward making the PIOB a truly global independent oversight body.

¹ Standard setting refers to the areas of auditing and assurance, ethics and education for accountants.

² These are the International Auditing and Assurance Standards Board, the International Ethics Standards Board for Accountants and the International Accounting Education Standards Board.

The PIOB is confident that its first two years of activity have laid a foundation for higher quality and more effective oversight.

The PIOB held four plenary meetings during its second year. In June and September 2006, and again in March 2007, the PIOB met at its Madrid headquarters. Its December 2006 meeting took place in Tokyo where the PIOB was hosted by the Japanese Financial Supervisory Agency. During those meetings the PIOB received and discussed reports from IFAC leaders and the chairs and staff of boards and other groups within the scope of its oversight. It reached decisions on the composition of boards and the CAP for 2007 and on adding new members to the CAGs. It determined whether due process had been fully complied with before approving the publication of several key international standards. It directed the development of its own organization and monitored the disposition of its budget. And it worked diligently to develop its relationships with other regulatory bodies and stakeholders.

The PIOB is confident that its first two years of activity have laid a foundation for higher quality and more effective oversight. The PIOB also believes that its presence and influence have resulted in a greater awareness of and more explicit attention to public interest concerns during the process of international standard setting. Nevertheless, more needs to be done so that both the vision and the benefits of public oversight as contemplated under IFAC reforms can be brought to full fruition.

The following sections of this report provide a more detailed picture of the PIOB's second year of

operation. They highlight the actions and decisions taken, outline the policies adopted and implemented and provide an assessment of the results of this activity.

II. OVERSIGHT OF IFAC PUBLIC INTEREST ACTIVITY COMMITTEES (PIACs)

MONITORING ACTIVITIES

...active monitoring... focuses on the efficiency, the quality and the progress made at each successive PIAC meeting. In all these respects, the standard setting boards subject to PIOB oversight have operated satisfactorily, exhibiting professional behavior; good organization, good support by well-qualified staff and an increasing effort to produce valid outputs.

PIOB oversight extends to three standard-setting boards: the International Auditing and Assurance Standards Board (IAASB) the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB). Oversight also extends to the three Consultative Advisory Groups (CAGs) established to provide input to each of these boards, and to the Compliance Advisory Panel (CAP), the body that evaluates IFAC member body compliance with their obligations to IFAC, including those obligations in respect of international standards.

³ For a full discussion of the PIOB's mandate and responsibilities, see "International Federation of Accountants Reform Proposals 10 September 2003", pp. 9-14.

⁴ PIOB members, observers or, where required, the Secretary General.

From the very beginning, the PIOB committed itself to the comprehensive monitoring of designated standard-setting activities. To maintain this commitment, PIOB representatives⁴ observed a total of fifteen meetings of standard-setting boards and CAGs during the second year of operation.

This active monitoring program focuses on the *efficiency*, the *quality* and the *progress* made at each successive PIAC meeting.

Monitoring for *efficiency* means carefully evaluating:

- the preparations made for each meeting;
- task force effectiveness in considering comments from CAG and other respondents to the exposure process, communicating their findings and conclusions and making recommendations to the full board;
- the level of member participation;
- each chair's ability to bring debates to constructive conclusions while allowing all valid points of view to be aired; and
- the attention paid to forward planning of developing work, public consultations and meetings with stakeholders such as national standard setters and regulators.

Monitoring the *quality* of deliberations means evaluating the substance and diversity of views expressed. It also means tracking the incidence of explicit public interest questions and the contributions of public members on each of the standard-setting boards⁵ and assessing the impact of comments from the CAG. Further, in the view of the PIOB, the quality of deliberations is determined by how well the standard-setting boards pay attention to the needs and concerns of constituencies that deserve special focus from a public interest perspective. The views of groups such as national standard setters, public sector

auditors, small and medium-sized enterprises, and developing nations are also relevant to establishing the validity and applicability of international standards for global use. All three standard-setting boards have demonstrated clear interest in and responsiveness to the views of one or more of these additional constituencies, although the IAASB's more systematic coordination of its own work with them could be a useful model for adoption by the other two boards.

Finally, monitoring *progress* means evaluating the forward movement achieved at each meeting toward either an exposure draft or a final published standard in the context of existing work plans and established time lines. This is especially relevant with respect to the IAASB "Clarity Project" which is an ambitious program designed to restate International Standards on Auditing (ISAs) in a more effective format and with clearer terminology within a specific time horizon⁶.

In all these respects, the standard-setting boards subject to PIOB oversight have operated satisfactorily, exhibiting professional behavior, good organization, good support by well-qualified staff and an increasing effort to produce valid outputs. As a consequence of its observations, the PIOB has made a series of recommendations for improvement in process and planning. As a rule, the chairs and boards have responded to these recommendations in a satisfactory manner.

Ongoing monitoring of all CAG meetings has permitted the PIOB to assess the functioning of this important component of due process. In the PIOB's view, the IAASB CAG operates in a well-organized manner under an independent chair. This CAG offers helpful consultative advice to its board and its contribution has become an integral part of the system within which existing and new International Standards on Auditing are being developed using the new "clarified" format.

⁵ Each Board includes three "public members". These are non-practitioner experts who are explicitly selected to represent a public interest perspective.

⁶ The "Clarity Project" is the strategic undertaking of the IAASB that seeks to convert all International Standards on Auditing to a new format that clearly delineates objectives, requirements and guidance for implementation.

The PIOB is satisfied that all three CAGs maintain an independent perspective, are capable of producing comprehensive views from a broad array of stakeholders and are working to fulfill their commitment to provide standard setters with valuable technical guidance.

As noted in its first public report, the PIOB strongly encouraged the IESBA and IAESB CAGs to identify and bring forward well-qualified and independent chairs for PIOB approval. This objective was accomplished by the spring of 2006. As a consequence, the operation of these two groups has improved considerably during the past year, resulting in more substantial contributions to the work of their respective standard-setting boards. Also, all three CAGs have adopted the “sunshine” policy discussed in the PIOB’s first public report and now meet in public.

The PIOB is satisfied that all three CAGs maintain an independent perspective, are capable of producing comprehensive views from a broad array of stakeholders and are working to fulfill their commitment to provide standard setters with valuable technical guidance.

While first-hand monitoring of CAP meetings did not occur during the period of this report, the CAP chair and staff provided regular reports to the PIOB on the progress of their compliance project. This project has now moved from an initial fact-finding stage to a second stage in which member bodies have been asked to self-assess their compliance with IFAC membership obligations. Of particular interest to the PIOB, these obligations include the requirement to adopt (or, where member bodies do not have the authority to adopt, to use their best endeavors to have adopted), implement and properly

apply international standards on auditing and assurance, ethics and education. Based on the CAP’s reports, the compliance project is well advanced and, through the significant amount of data collected, has already provided valuable insights into the variety of standard-setting and implementation models in use around the world. In view of the progress made during this second stage and the importance of the next and final stage of this effort, the PIOB intends to commence active observation of CAP meetings during 2007.

DIALOGUE WITH IFAC

In keeping with the spirit of cooperation reflected in the IFAC reform document, the PIOB and IFAC have maintained a continuous and constructive dialogue since March 2005. This dialogue focuses on the IFAC activities falling within the scope of PIOB oversight and covers such wide-ranging issues as terms of reference, membership, and the role of the IFAC Board and Council where the IFAC Constitution requires relevant decisions to be taken at these levels. This dialogue has also provided the opportunity to discuss PIOB policy decisions and resulting recommendations for improving IFAC processes. Finally, this dialogue ensures that the PIOB remains informed on broader trends and developments within IFAC that could have a significant effect on relevant public interest groups and activities. This particular interest reflects the PIOB’s belief that the entire operation of IFAC and its various structures create both the context and the incentives to encourage the pursuit and achievement of public interest objectives. Accordingly, the PIOB plans to continue to monitor whether IFAC’s general orientation and operation are congruent with and conducive to achieving international public interest objectives.

Overall, the relationship between the PIOB and IFAC has continued to develop in an open and constructive fashion during the second year of PIOB operation.

Interaction between the PIOB and IFAC takes a number of forms, each with a specific approach and purpose.

At the PIOB's regular quarterly meetings, IFAC leadership normally provides an update on the progress of the current year's nominations process. These meetings also include updates on the progress of the work of various IFAC public interest boards and committees, general IFAC developments and changes in IFAC policies. Finally, these meetings provide a forum where IFAC can raise substantive or procedural issues for the PIOB's consideration. In turn, the PIOB poses questions, clarifies understandings, makes observations on what has been reported or presented and discusses emerging PIOB policies with IFAC.

The PIOB Chairman normally attends every IFAC Board meeting and the annual meeting of IFAC Council as an observer. Where appropriate, the Chairman uses these occasions to address Board and Council members and inform them of PIOB policies and recommendations, progress and goals.

Prior to each PIOB meeting, IFAC provides written information on specific items that the PIOB has indicated are priorities as well as items that IFAC has asked to be placed on the PIOB agenda for discussion or approval. These items are discussed with IFAC representatives at the meeting, followed by private deliberations to reach the PIOB's own conclusions. Final views, decisions and policies are

communicated in writing to IFAC shortly after each quarterly meeting. This same process is pursued for specific requests from standard-setting boards or other groups, for example decisions on due process completion, consents to new CAG memberships or changes in board terms of reference.

At its December 2006 meeting, the PIOB was asked to address the critical question of standard-setting observerships for major authorities engaged in or overseeing audit regulation. In the case of the IAASB, the PIOB agreed to the renewal of existing observer arrangements, including rights of the floor, for the US Public Company Accounting Oversight Board (PCAOB) and the Japanese Financial Supervisory Agency. The PIOB also agreed to a proposal to invite these two agencies and the European Commission to accept similar positions on the IESBA. In the PIOB's view, the benefits of this policy are twofold. First, participation by major audit regulatory authorities will promote the development of standards acceptable for future convergence purposes. Second, the presence of representatives from major audit oversight authorities has already proven beneficial in preventing serious inconsistencies between international and key national standards.

In its first public report the PIOB encouraged IFAC to take steps to strengthen its commitment to the public interest. In response, IFAC has initiated a project to develop an operational definition of the public interest that can be applied to all its activities, whether overseen by the PIOB or not. The PIOB welcomes this initiative but also believes that it must be coordinated with the PIOB's own ongoing efforts to develop the concept and identify elements of the international public interest.

In November 2006 Graham Ward retired as President of IFAC and was succeeded by Fermin del Valle. During his presidency, Mr. Ward worked

diligently to promote and sustain cooperation between IFAC and the PIOB in implementing IFAC reform. It is our expectation that the same close cooperation will continue with his successor.

Overall, the relationship between the PIOB and IFAC has continued to develop in an open and constructive fashion during the second year of PIOB operation. The PIOB has heard and evaluated all matters presented to it by IFAC without delay; in return, the leadership of IFAC has fully respected the independence of the PIOB and has sought to implement the PIOB's recommendations in a timely and effective manner. On the whole, the relationship has been fruitful and holds positive promise for the future.

III. DUE PROCESS EVALUATION

No international standard on auditing, ethics or education can be published before the PIOB is satisfied that due process has been followed.

One of the PIOB's first year priorities was to seek, obtain and approve a new description of due process to be applied to all three standard-setting boards in a consistent and rigorous manner. As a part of the PIOB's new due process evaluation procedure implemented during the second year of operation, each standard presented for PIOB approval prior to final publication must now be accompanied by an individual evaluation of due process completion. This document, prepared by IFAC's Executive Director, Professional Standards, sets out the steps that should be taken during the standards development cycle to ensure the adequacy of public exposure, consultation and response to public comments and certifies that all relevant steps have been properly followed. The PIOB reserves the right to question and examine any detail of due process.

The PIOB expects the due process element of its program to increase due to the impact of the Clarity project. Because increasing numbers of jurisdictions are interested in adopting international standards, stakeholder interest in due process will also increase.

During its second year of operation the PIOB evaluated and approved due process completion for eight IAASB standards in final closed-off form⁷, four additional IAASB standards in final clarified form, the Preface to the International Standards on Auditing, the "Network Firms" portion of Section 290 of the IFAC Code of Ethics and one standard finalized by the IAESB. A list of these standards is included as Appendix D to this report. The PIOB expects the due process element of its program to increase due to the impact of the Clarity project. Because increasing numbers of jurisdictions are interested in adopting international standards, stakeholder interest in due process will also increase.

In order to identify possible further improvements to the current due process model, the PIOB initiated a focused dialogue with standard setters on the model's detailed operation. After several discussions, the PIOB has identified three substantive features of this model which, in its view, pertain directly to the achievement of public interest objectives and therefore require the PIOB's close and ongoing attention:

- There is a need to ensure that CAG comments are being adequately considered. One way to achieve this is to enlist the support of CAG chairs to verify that the views of each CAG have

⁷This term describes a standard which has been finalized with respect to technical content but which must be redrafted in the new clarified format.

been conveyed to the respective board and to report on whether and how these views have been addressed in the final standard.

- There is also a need to ensure that comments coming from stakeholders who represent a strong public interest perspective are being considered in a comprehensive and responsive fashion.
- Finally, there is a need to see that the “Basis for Conclusions”, required by due process to be published together with the final standard, is an effective document. The PIOB wishes to ensure that this will offer a comprehensive, well-founded and persuasive statement that explains the conclusions reached by each board and, especially where stakeholder arguments were not accepted, the reasoning used to reach the board's final decision.

Dialogue between the PIOB and standard setters will continue and a final PIOB policy position on future due process improvements is planned for the coming year.

IV. OVERSIGHT OF NOMINATIONS

One of the PIOB's primary responsibilities is to approve all nominations to each of the standard-setting boards and the CAP. To discharge this responsibility, the PIOB closely monitors the nominations process through direct observation of all meetings of the IFAC Nominating Committee and regular consultations with IFAC leadership on nominations issues. The PIOB is also asked to review and consent to the appointment of new CAG members to help ensure that such appointments will further diversify the CAG's membership and improve its contribution to the standard-setting process.

During the second year of its operations, the PIOB continued to encourage additional improvements to both the nominations process and its results. Two important changes were made since the last PIOB public report. First, IFAC has increased the number of “public members” from two to three on the IAESB and the IESBA and the number of CAP members from five to six in order to achieve greater geographic diversity. Both changes were implemented for the 2007 nominations cycle completed in September 2006. Also, the 2007 call for nominations, which marks the start of the IFAC nominations cycle, was much more comprehensive and emphasized the need for appointments in both practitioner and non-practitioner categories. This separation was intended to highlight the need for more non-practitioners on each standard-setting board and to encourage expressions of interest from highly qualified candidates.

Based on its second year of extensive observation, the PIOB concluded that IFAC's nominations process was transparent, professionally conducted and balanced.

Following the PIOB's strong recommendation, the IFAC Nominating Committee produced 2007 nominations slates for each of the standard-setting boards that demonstrated concrete improvements in the balance of practitioner and non-practitioner experts. While IAESB parity had already been achieved for 2006, specific targets were set and achieved for the two remaining boards during the 2007 nominations cycle. In the case of the IESBA, the number of non-practitioners appointed for 2007 was sufficient to achieve the required balance. In the

case of the IAASB, the PIOB did not seek immediate parity so as to ensure an orderly transition. However, the Nominating Committee effected a major improvement to the IAASB's composition by increasing the number of non-practitioner members to 7 out of 18, or 40 percent of the board. Also, improvement was noted in the nominations process used by the Transnational Auditors Committee (TAC) who, in response to the PIOB's request, presented more candidates than the number of vacancies available on the standard-setting boards. These developments are positive steps towards fulfilling the goals stated in both the IFAC reform document and PIOB policy.

In its first public report, the PIOB expressed its view that all three standard-setting boards should be composed of an equal number of practitioner and non-practitioner members so as to strengthen the board's independence, provide a strong diversity of backgrounds, perspectives and opinions and elevate external credibility. Nevertheless, the PIOB realizes that members of standard-setting boards must also be highly qualified experts and able to work together towards a high quality conclusion. It is therefore recognized that the practitioner/non-practitioner criterion is only one of several to be considered in the choice of members for each standard-setting board and that IFAC nominations should also reflect geographic and cultural diversity, gender balance and a mix of practical experience drawn from both large and small firms. The PIOB recognizes and welcomes the strong commitment and continuing efforts of the IFAC Nominating Committee to achieve these demanding objectives.

During 2006, the IAASB faced an important issue – recruiting to fill the vacancy created by the expected retirement of its chair, John Kellas, at the end of the year. This issue was resolved through Mr.

Kellas's agreement to serve for two more years and the PIOB approved his reappointment at its June meeting. Given the importance of this particular position, the PIOB has urged IFAC to initiate its search for the next chair of the IAASB well in advance of the 2009 nominations cycle and notes that the IFAC Nominating Committee is already taking steps in that direction.

In June, the PIOB also approved interim appointments to the newly created Deputy Chair positions on each of the IESBA and IAESB. In September, after the conclusion of the 2007 nominations process, the PIOB approved full slates of nominees for all three standard-setting boards and the CAP. Based on its second year of extensive observation, the PIOB concluded that IFAC's nominations process was transparent, professionally conducted and balanced. The individuals approved for appointment to the 2007 standard-setting boards are persons of high competence and professional integrity. In addition to other favorable changes, the PIOB also welcomes the improved geographical representation within the CAP.

The composition of CAG membership should ensure that an adequate number of varied and responsible stakeholders participate in CAG deliberations, as this type of consultative engagement in the standard-setting process is an efficient way for the standard-setting boards to obtain widely-based views, high quality technical comment and sound advice. During its second year of operation, the PIOB considered proposals to appoint three additional members to each of the IAASB and IAESB CAGs. The PIOB consented to these additions, having concluded that the member organizations or individuals appointed would offer increased diversity and scope of regional and sectoral coverage.

V. INITIATION OF PIOB REVIEW OF FUTURE WORK PLANS

During this past year the PIOB proposed that the standard-setting boards use a common process to review existing plans and priorities and develop work plans for the next few years.

An important part of the PIOB's mandate is to evaluate the appropriateness and completeness of the work plans developed by each of the standard-setting boards. Although all three boards are primarily occupied with projects that were initiated before the PIOB was formed, questions remain as to what strategic plans and priorities should be established and how the boards should go about this task.

During this past year the PIOB proposed that the standard-setting boards use a common process to review existing plans and priorities and to develop their work plans for the next few years. This process has now been developed through the collective efforts of IFAC leadership, the board and CAG chairs and IFAC staff, in consultation with the PIOB.

The first step in this common process requires development of a survey questionnaire to seek the views of a broad range of stakeholders on existing priorities and suggestions for potential new projects. The second step involves developing draft work plans for preliminary consideration by and input from each board's respective CAG. The third step exposes the draft plans for formal public comment. After a standard-setting board has considered this input and made any final revisions as appropriate,

the PIOB will evaluate the plan for completeness and, if considered necessary in the public interest, propose additions. Although they are at different stages, all three standard-setting boards have embarked on this process. Its timely completion will enable the PIOB to review and evaluate each board's work plans and priorities within the next year.

VI. PIOB DIALOGUE WITH THE INTERNATIONAL REGULATORY COMMUNITY

In addition to developing its relationship with The Monitoring Group, the PIOB has launched an outreach program to assist in communicating its mandate, goals and policies to the world regulatory community at large as well as to other related stakeholders and organizations. The PIOB has called this the "visibility project".

As noted at the beginning of this report, it is the international community of financial regulators which has sponsored the PIOB. Three of these regulatory organizations (IOSCO, BCBS and the IAIS) together with The World Bank, the European Commission and the FSF, have formed The Monitoring Group, currently chaired by Commissioner Roel Campos of the US Securities and Exchange Commission. Each of the PIOB's international sponsors maintains a very keen interest in the issue of audit quality in which robust standard setting plays an

important role. Thus, The Monitoring Group provides a forum that promotes cohesive dialogue on issues related to both the progress of IFAC reform and related issues affecting global audit quality. A separately constituted Nominating Committee of The Monitoring Group conducts the due process established by The Monitoring Group for appointing PIOB members. The PIOB also maintains a close link to The Monitoring Group, reflected in the PIOB Chair's participation in Monitoring Group meetings, regular presentation of reports on the activities and policies of the PIOB and periodic discussions between the chair of The Monitoring Group and the PIOB.

In addition to developing its relationship with The Monitoring Group, the PIOB has launched an outreach program to assist in communicating its mandate, goals and policies to the world regulatory community at large as well as to other related stakeholders and organizations. The PIOB has called this the “visibility project”.

It is very important for the PIOB to raise global awareness of its mission and work. This means keeping regulators and other stakeholders abreast of developments in pertinent areas of international standard setting for the accountancy profession. As all these organizations have projects and groups focused on audit issues, it is essential for the PIOB to communicate its actions, policies and achievements in order to explore synergies, share agendas and priorities and coordinate activities wherever practical.

In the pursuit of this goal, PIOB representatives made a large number of presentations over the last twelve months (see Appendix E). As a result, many members of the international regulatory community became better informed about the PIOB and its activities and engaged in dialogue with PIOB mem-

bers and staff on matters of common interest, especially in the areas of audit effectiveness and professional ethics. This interaction has also set the stage for the establishment of more permanent links between the PIOB and financial regulators around the world. As such links are important sources of input to the PIOB's own planning and priorities, the PIOB will continue to pursue its policy of open and broad communication with the world regulatory community.

VII. LINKS WITH INDEPENDENT AUDIT REGULATORS

... the PIOB believes that independent audit regulators can offer valuable insights on priorities and the applicability of international standards.

In its first public report the PIOB noted several important changes in the world regulatory landscape due to the emergence of new independent audit regulators. It also noted the parallel but distinct interests of these new regulators and the PIOB and the need to open channels of communication.

In September 2006, a large number of national audit regulators from major jurisdictions around the world established the International Forum of Independent Audit Regulators (IFIAR). The PIOB welcomed the establishment of this forum and publicly expressed its intention to forge strong links with this important group. The PIOB subsequently invited the newly-elected chair of IFIAR,

Mr. Jeffrey Lucy, to participate in a telephone discussion with the PIOB during its December 2006 meeting. This discussion covered IFIAR's agenda and prospects as well as other matters of mutual interest.

The PIOB is charged with overseeing the process of setting international auditing, ethics and education standards while IFIAR is a forum for those who oversee and inspect the implementation and application of these standards by auditors. It is clear that both groups share the broad objective of enhancing audit quality, and the PIOB believes that independent audit regulators can offer valuable insights on priorities and the applicability of international standards.

The PIOB looks forward to further contacts with IFIAR and possible future cooperation consistent with the distinct goals of each entity. The PIOB also maintains bilateral contacts with a number of audit regulatory authorities to promote exchanges of information on goals, policies and priorities.

VIII. PIOB PRESENTATIONS TO THE ACCOUNTING PROFESSION

As the PIOB works to improve the quality and credibility of international standards, potential users should be made aware of the PIOB's efforts, policies and goals. It is the PIOB's belief that this awareness will make the adoption and use of international standards more attractive and promote convergence...

Another focus of the “visibility project” has been the worldwide accounting profession. In addition to addressing IFAC assemblies, the PIOB recognizes the importance of reaching out to national organizations and institutes of professional accountants and auditors. Not only are these organizations the primary supporters of IFAC policies, they are also a primary source of nominations and support for experts who become members of standard-setting boards. Furthermore, and perhaps even more importantly, they are the bodies charged with adopting, or promoting the adoption of, international standards.

Members of these bodies are the auditors who must apply international auditing standards. They are the auditors and accountants who, by their behavior, must exemplify and validate the international code of ethics. They are also the professionals who must undergo and apply the results of lifelong education and training based on the rigor and quality of international educational standards. In short, these preparers and auditors of financial statements and other professional accountants are core users of international standards.

The importance of PIOB contacts with these groups is self-evident, and as the PIOB works to improve the quality and credibility of international standards, potential users should be made aware of the PIOB's efforts, policies and goals. It is the PIOB's belief that this awareness will make the adoption and use of international standards more attractive and promote convergence with these standards.

In that context, PIOB representatives visited several national or regional accounting and auditing organizations during this year to explain the character, activity, policy and goals underlying the PIOB's public interest mission. The PIOB Chairman and

other PIOB representatives spoke at the World Accounting Congress in Istanbul. The Chairman also addressed the Institutes of Certified Public Accountants of Japan, Greece and Cyprus, the Fédération des Experts Comptables Européens and the Global Public Policy Symposium organized by the six largest international audit firms. In the context of monitoring standard-setting activities, PIOB members have also attended local seminars organized between the standard-setting boards and local professional bodies. These encounters have provided opportunities to gain greater insight into local needs and issues in various parts of the world and to further promote awareness of the PIOB and its mission.

Presentation of the PIOB's mission and policy has proven to be a useful and rewarding way to increase the accounting profession's awareness of issues related to international standard setting in the public interest. The PIOB will therefore continue to pursue appropriate future opportunities of this kind.

IX. THE INTERNATIONAL PUBLIC INTEREST REVISITED

The quest for higher quality financial reporting and high quality audits of financial reports is a single global mission requiring the efforts of numerous stakeholders including the accounting profession.

In section IV of its first report, the PIOB discussed the public interest in the context of global markets.

The PIOB stated its perception that it was in the public interest:

- to produce international standards that would cover all aspects of the audit process and the education and conduct of those engaged in preparing and auditing financial statements;
- to produce standards that would be not only of high-quality but also of high clarity and usability;
- that those who set international standards should be committed to the public interest, should act independently of special or personal interest and should be agile and responsive to emerging needs of standard users;
- to promote compliance with IFAC standards by the member bodies of IFAC around the world; and
- that the process by which international standards were developed should be open, transparent and responsive to the views and needs of all who would use or be subject to the standards and involve standard setters who were knowledgeable, experienced and diverse.

Moreover, it was felt that promotion of all these elements of the international public interest would enhance convergence to a common set of standards worldwide. The PIOB also stated its expectation that as its knowledge and understanding of the international standard setting process increased, and as its approach to oversight became more refined, it would elaborate further on its initial insights into what serves “the public interest”.

Based on a further year of oversight experience, the PIOB has developed a clearer understanding of the broader context within which it operates. The quest for higher quality financial reporting and high quality audits of financial reports is a single global mission requiring the efforts of numerous stake-

holders including the accounting profession. The objective is a reliable and transparent financial communications model within which both reporting and auditing play distinct but mutually reinforcing roles.

The PIOB understands that the international public interest must be securely anchored by the objective of satisfying those who use financial information and rely on auditors and the audit process. Although user needs may vary widely from group to group and expectations may differ between users and providers of services, the international public interest is best served by clear communication of the objectives of both financial reporting and auditing.

This is where the professional standards that govern the creation of financial reports and delivery of audit services become critical. The scope and nature of international financial reporting and auditing standards must deal not only with reporting and auditing activities but also with the behavior and qualifications of both the accountant and the auditor. Comparability between local and international standards should be clear, as should the extent to which accountants and auditors have complied with the relevant standards.

...it is not enough for international standards to be of high quality and broad applicability. It is also necessary for international standard setting itself to be credible...

The PIOB believes that high quality international auditing standards are indispensable in meeting international public interest objectives. To be widely accepted and adopted, such standards must include clear objectives and sound principles and be of high technical quality. They must also be clearly written

for ease of understanding and application. The standards should be operable in the context of local environments that may vary widely in terms of level of development, legal system and regulatory requirements. They should also be suitable for application in a variety of auditor and client situations.

But it is not enough for international standards to be of high quality and broad applicability. It is also necessary for international standard setting itself to be credible so that its products will be perceived as appropriate and achieve wide acceptance. In this regard, the standard-setting process must be transparent, forward-looking and flexible, provide ample opportunity for stakeholder input and be subject to independent oversight.

Standard setters should be knowledgeable, experienced and committed to the public interest. This commitment to the public interest should be evidenced by their willingness to act independently, their responsiveness to emerging needs and their openness to input. Standard setters should also be drawn from diverse backgrounds, for example, by professional experience, regional affiliation and gender. Finally, the process of selecting the standard setters should itself be transparent, provide opportunity for stakeholder input and be subject to independent oversight.

The promotion of standard quality and credibility as elements of the international public interest are central to the PIOB's mandate and, as they are achieved, will facilitate widespread acceptance and effective implementation of international standards.

It is clear that the process of adoption and effective implementation in the global environment requires multiple and coordinated efforts.

It is noted that many other parties can play a role in the **adoption** of international standards. They include IFAC and its member bodies, the international standard-setting boards and various international bodies such as organizations of regulators and The World Bank. On the other hand, mechanisms such as internal quality assurance programs, external quality reviews by financial sector and audit regulators and self-evaluation can contribute to the effectiveness of the **implementation** of inter-

national standards. It is clear that the process of adoption and effective implementation in the global environment requires multiple and coordinated efforts.

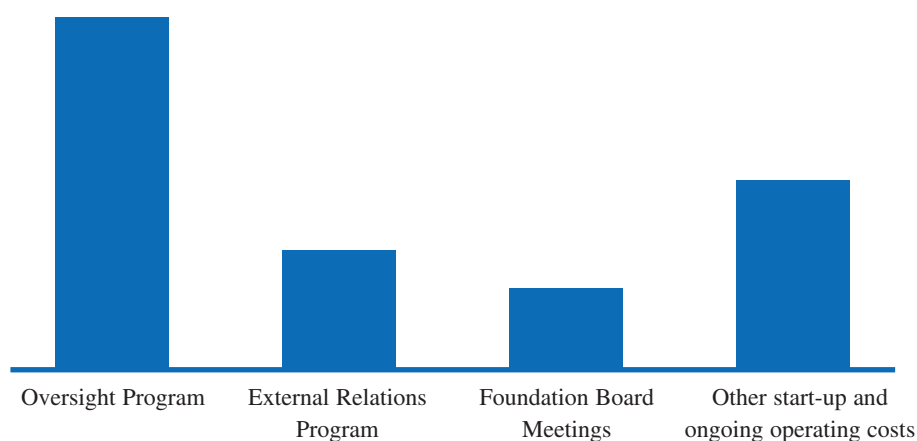
By sharing these views, the PIOB hopes to clarify and give operational content to the objectives of IFAC reform, to promote additional dialogue among stakeholder communities and to encourage increased coordination of mandates toward the achievement of international public interest goals.



X. SUMMARY STATEMENT OF FINANCIAL PERFORMANCE

PIOB FOUNDATION (1) For the year ended December 31, 2006 (in Euros)

TOTAL REVENUES (2)	893,779
EXPENSES BY ACTIVITY	
Board-related operating costs	
Oversight Program	461,171
External Relations Program	132,589
Foundation Board Meetings	85,900
Other start-up and ongoing operating costs	214,119
TOTAL EXPENSES	893,779



(1) The PIOB operates as a Technical Committee of its Spanish not-for-profit foundation, La Fundación Consejo Internacional de Supervisión Pública en Estándares de Auditoría, Etica Profesional y Materias Relacionadas ("the PIOB Foundation" or "the Foundation"). Subject to the limits set out in (2) below, the Foundation operates on a breakeven basis.

(2) PIOB total revenues for 2006 were contributed primarily by the International Federation of Accountants (IFAC) under a commitment made in the 2003 IFAC Reforms to cover the PIOB's funding at the level agreed to (initially not to exceed US

\$1,500,000), adjusted for inflation and foreign currency adjustments, for a period of five years. In addition to IFAC's individual contribution of EUR 782,191, a further EUR 111,588 in targeted funding was provided to IFAC by the World Bank and the US Federal Reserve Board.

The PIOB's auditor, BDO Audiberia S.L., delivered an unmodified report on the complete financial statements of the Foundation. The full version of these statements and the auditor's report are available separately on the PIOB web site at www.ipiob.org.



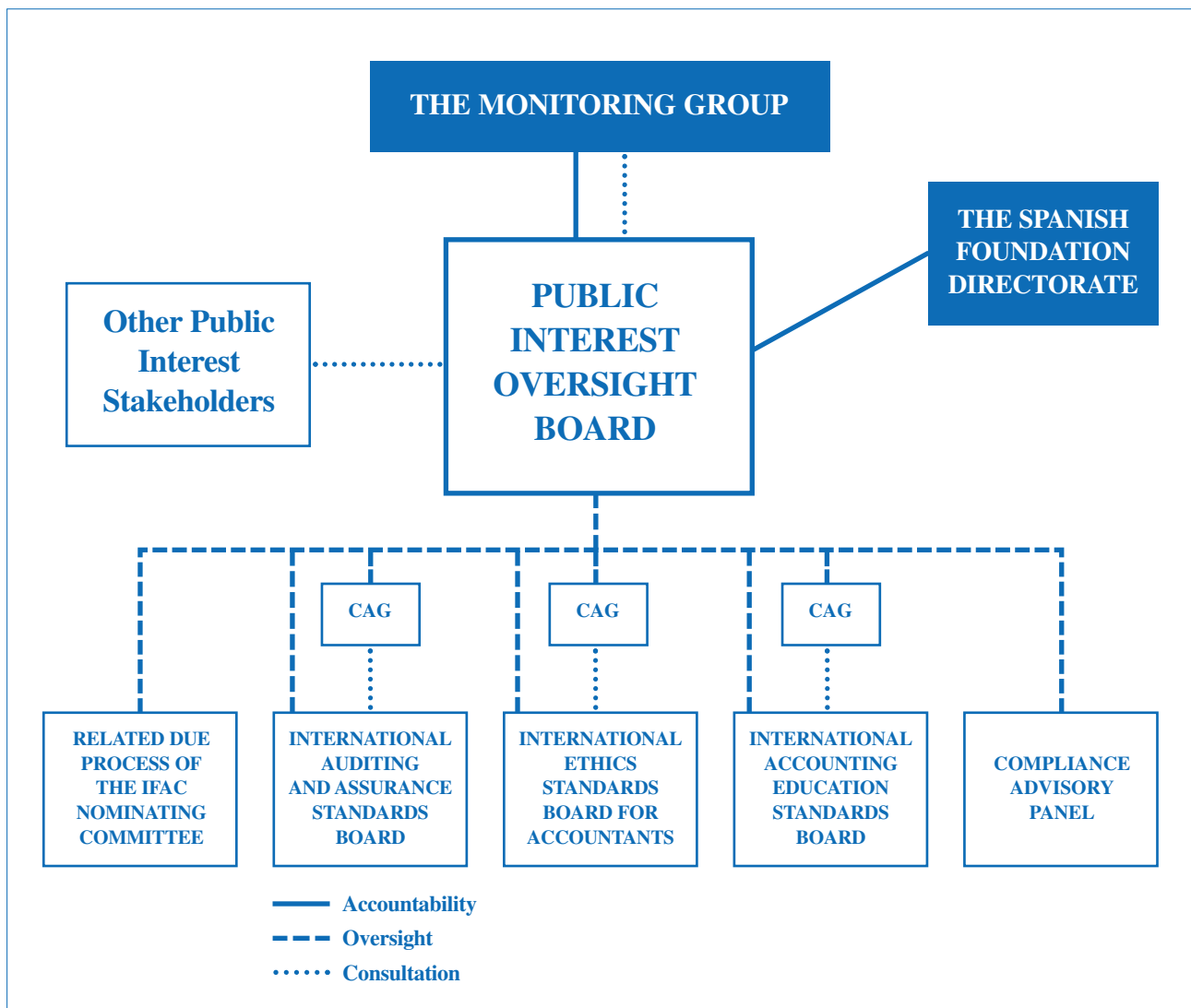


Appendices

- A. The PIOB Operating Environment
- B. The PIOB
- C. PIOB Sponsors (“The Monitoring Group”)
- D. International Standards Approved for Due Process Completion
- E. PIOB Visibility Program
- F. Celebrating the PIOB’s First Anniversary in Spain

Appendix A.

THE PIOB OPERATING ENVIRONMENT



The PIOB’s core activities are conducted through a Technical Committee of the Fundación Consejo Internacional de Supervisión Pública en Estándares de Auditoría, Ética Profesional y Materias Relacionadas (“the PIOB Foundation”).

As Spanish Foundations are considered high public interest entities, the PIOB Foundation is

itself subject to oversight by the Spanish Foundations Protectorate. In addition to its core oversight program, the PIOB establishes and maintains close relations with a variety of external public interest stakeholders. The PIOB’s relationship with The Monitoring Group is described in the IFAC Reform Proposals.

Appendix B.

THE PIOB



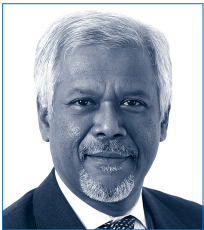
Dr. Stavros Thomadakis, Chairman

Professor of Finance, University of Athens, Greece. Former Chairman of the Hellenic Capital Market Commission, the European Regional Committee of IOSCO, and the expert group on Market Abuse of the Committee of European Securities Regulators.



Mr. Antoine Bracchi

Président, Conseil National de la Comptabilité



Mr. Fayezul Choudhury

Vice-President and Controller, The World Bank Group



Prof. Dr. Kai-Uwe Marten⁸

Professor of Accounting and Auditing, University of Ulm, Germany. Deputy Chairman of the Auditor Oversight Commission, Federal Republic of Germany



Sir Bryan Nicholson, GBE⁹

Former Chairman of the UK Financial Reporting Council



Prof-Dr. Arnold Schilder, RA

Executive Director, De Nederlandsche Bank NV, Netherlands. Member of the Basel Committee on Banking Supervision and Chair of the Basel Committee's Accounting Task Force 1999-2006



Mr. David A. Brown, Q.C.

Former Chair of the Ontario Securities Commission, Canada. Founding Chair of the Council of Governors of the Canadian Public Accountability Board. Member of the Council of Senior Advisors to the Auditor General of Canada



Mr. Michael Hafeman

Actuary and independent consultant on supervisory issues. Former Assistant Superintendent of Financial Institutions, Canada



Mr. Kosuke Nakahira

President and Chief Executive Officer, Shinkin Central Bank. Former Vice-Minister of Finance for International Affairs, Ministry of Finance, Japan



The Hon. Aulana L. Peters

Retired lawyer, Former Commissioner of the U.S. Securities and Exchange Commission. Former member of the Public Oversight Board of the American Institute of Certified Public Accountants. Member, Accountability Advisory Board to the U.S. Comptroller General.



Ms. Donna M. Bovolaneas, CA

PIOB Secretary General

⁸ Observer nominated by the European Commission.

⁹ Ibid.

Appendix C.

PIOB SPONSORS ("THE MONITORING GROUP")

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

IOSCO is recognized as the international standard setter for securities markets. The Organization's wide membership regulates more than 90% of the world's securities markets and IOSCO is the world's most important international cooperative forum for securities regulatory agencies. IOSCO members regulate more than one hundred jurisdictions and the Organization continues to grow. It is headquartered in Madrid, Spain.

THE BASEL COMMITTEE ON BANKING SUPERVISION (BCBS)

The Basel Committee was established by the central-bank Governors of the Group of Ten countries at the end of 1974. Its members represent the central banks and, where separately constituted, the banking supervisory authorities from thirteen of the world's key markets. Although without formal supranational supervisory authority, the Basel Committee formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements best suited to their own national systems. In this way, the Committee encourages convergence towards common approaches and standards.

THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS)

Established in 1994, the International Association of Insurance Supervisors (IAIS) represents insurance regulators and supervisors from some 180 jurisdictions. The IAIS issues insurance supervisory principles, standards and guidance papers to promote effective insurance supervisory regimes, provides training and support on issues related to insurance supervision, and organizes meetings and seminars for insurance supervisors. The IAIS works closely with other financial sector standard-setting bodies and international organizations to promote financial stability.

THE WORLD BANK GROUP

The World Bank is a vital source of financial and technical assistance to developing countries around the world. Not a bank in the common sense, The World Bank is made up of two unique development institutions owned by 185 member countries – the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Each institution plays a different but supportive role in The World Bank's mission of global poverty reduction and the improvement of living standards. The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world. Together these development institutions provide

low-interest loans, interest-free credit and grants to developing countries for education, health, infrastructure, communications and many other purposes.

THE EUROPEAN COMMISSION

The European Commission is the executive branch of the European Union (EU). It has the “*right of initiative*” with respect to legislative proposals and as “*Guardian of the Treaties*” is responsible for controlling Member States’ implementation of EU legislation. As part of the completion of the European Single Market, an ongoing initiative which aims to ensure the free movement of people, goods, services and capital, the European Commission is fully committed to ensuring harmonious and timely implementation of the modernized “*8th Company Law Directive*” on statutory audits. This Directive, a mandatory legal text across the EU, was adopted in 2006 by the European Council and Parliament and must be implemented by June 2008. Its goal is to improve the quality of audits by specifying the duties of statutory auditors, their independence and ethics and by requiring Member States to introduce external quality assurance and oversight structures. The Directive also deals with the treatment of non-EU auditors¹⁰. The European Commission is heavily involved in international cooperation and is a key player in promoting stable and effective global financial markets driven by common rules and standards.

THE FINANCIAL STABILITY FORUM

The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. On a regular basis the Forum brings together national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSF seeks to co-ordinate the efforts of these various bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk.

¹⁰ More information on EU statutory auditing can be found in:
<http://ec.europa.eu/internalmarket/auditing/index.en.htm>

Appendix D.

INTERNATIONAL STANDARDS APPROVED FOR DUE PROCESS COMPLETION March 2006 - February 2007

One of the key responsibilities of the PIOB is to give its approval to final international standards prior to their publication. This approval is based on the PIOB's assessment of the due process completion certificate and related documentation prepared and presented by IFAC technical staff.

Due to the transitional effects of the Clarity Project, the PIOB also approves standards in "closed off" form. These standards have completed their initial due process with respect to technical content but must be redrafted into the Clarity format for a second public exposure process, after which they will be

presented again to the PIOB for due process approval.

Whenever possible these decisions are taken at quarterly meetings of the PIOB to permit essential discussions with IFAC technical staff and due deliberation. On occasion, the PIOB will review and approve these requests by written procedure where delaying publication until the next quarterly meeting of the PIOB would not be in the public interest.

The following international standards were presented and approved for compliance with due process during the PIOB's second year of operation:

INTERNATIONAL STANDARDS ON AUDITING – CLOSED OFF VERSION

- ISA 260 (REVISED) Communication with Those Charged with Governance.**
- ISA 320 (REVISED) Materiality in Planning and Performing an Audit.**
- ISA 450 Evaluation of Misstatements Identified during the Audit.**
- ISA 540 (REVISED) Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures), in accordance with the clarity drafting conventions.**
- ISA 705 (REVISED) Modifications to the Opinion in the Independent Auditor's Report**
- ISA 706 (REVISED) Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report**
- ISA 800 (REVISED) Special Considerations - Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.**
- ISA 805 Engagements to Report on Summary Financial Statements.**

INTERNATIONAL STANDARDS ON AUDITING – CLARIFIED FORM

- ISA 240 The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements.**
- ISA 300 Planning an Audit of Financial Statements.**

ISA 315 **Understanding the Entity and Its Environment and Assessing the Risk of Material Misstatement.**

ISA 330 **The Auditor’s Procedures in Response to Assessed Risks.**

In addition, the PIOB approved the **Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services.**

INTERNATIONAL ETHICS STANDARDS

SECTION 290 **Revision of “Network Firms” portion of Section 290 of the IFAC Code of Ethics for Professional Accountants**

INTERNATIONAL EDUCATION STANDARDS

IES 8 **Competence Requirements for Audit Professionals.**

Appendix E.

PIOB VISIBILITY PROGRAM

April 2006 - March 2007

DATE	AUDIENCE	PRESENTER
April 2006	IAIS Insurance Contracts Subcommittee	Donna Bovolaneas
April 2006	The Monitoring Group	David Brown
May 2006	IAIS Accounting Subcommittee and Technical Committee	Michael Hafeman
June 2006	IOSCO Annual Conference	Stavros Thomadakis
September 2006	European Audit Regulatory Committee	Stavros Thomadakis
October 2006	Asociación de Supervisores Bancarios de las Américas	Stavros Thomadakis
October 2006	Instituto Iberoamericano de Mercados de Valores	Donna Bovolaneas
February 2007	The Monitoring Group	Stavros Thomadakis
March 2007	Basel Committee on Banking Supervision	Stavros Thomadakis
March 2007	IOSCO Standing Committee 1	Donna Bovolaneas
March 2007	International Forum of Independent Audit Regulators	Kosuke Nakahira

Appendix F.

CELEBRATING THE PIOB'S FIRST ANNIVERSARY IN SPAIN 25 September 2006

In September 2006, the PIOB held a reception at its Madrid headquarters to mark the completion of its first year in Spain and to bring together the international community of PIOB stakeholders. Many guests attended, including the Secretary of State for Economic Affairs (Spain), the Governor of the Spanish Central Bank, the Chairman of the Spanish National Securities Commission, the Chairman of The Monitoring Group, the Chairman of the IOSCO Technical Committee, the Chairman of the Basel Committee on Banking Supervision, the President of IFAC, and the chairmen of the three IFAC standard-setting boards. Also present were other representatives of IOSCO, the BCBS, the IAIS, The World Bank, the European Commission, independent audit regulators, the Financial Stability Forum, and IFAC, as well as leaders of the Spanish accounting profession, diplomatic envoys and other notables. This event served to strengthen the ties of the PIOB with a wide range of stakeholders, in particular the broader international community of accounting, auditing and financial regulation.



David Vegara, Secretary of State for Economic Affairs (Spain) and Stavros Thomadakis, Chairman (PIOB).



Stavros Thomadakis and SEC Commissioner Roel Campos, Chairman (The Monitoring Group).



Kai-Uwe Marten, European Commission Observer (PIOB), Graham Ward, CBE, President 2004-2006 (IFAC), John Hegarty (The World Bank), John Kellas, Chairman (IAASB) and Jurgen Tiedje (European Commission).



Juan José Fermín del Valle, Deputy President (IFAC) and Fayezul Choudhury, Member (PIOB).



René Ricol, Past President 2002-2004 (IFAC), **Helen Saville**, wife of Chairman **Henry Saville** (IAESB) and **Richard George**, Chairman (IESBA).



Manuel Conthe, Chairman (CNMV, the Spanish National Securities Commission), **Nout Wellink**, President (De Nederlandsche Bank) and Chairman (Basel Committee on Banking Supervision) and **Stavros Thomadakis**.



Rodrigo Buenaventura (CNMV), **José María Roldán** (Banco de España), **David Vegara** and **Philippe Richard**, Secretary General (IOSCO).



David Brown, Member (PIOB), **Fayezul Choudhury**, **Sir Bryan Nicholson**, GBE, European Commission Observer (PIOB) and **Arnold Schilder**, Member (PIOB).



Ethiopis Tafara (SEC), **Kosuke Nakahira**, Member (PIOB), **Kai-Uwe Marten**, **Michael Hafeman**, Member (PIOB), **Aulana Peters**, Member (PIOB) and **Stavros Thomadakis**. In the foreground, **Philippe Richard**.



Aulana Peters and **Rocío Goudie** (PIOB).



Rafael Sánchez (CNMV), **Arnold Schilder**, **Peter Cooke** (IAIS) and **Donna María Bovolaneas**, Secretary General (PIOB).



José María Gassó, President (ICJCE, the Spanish Institute of Public Accountants), **Michel Prada**, Chairman (AMF, the French Financial Markets Authority), Chairman (IOSCO Technical Committee) and former Chairman (The Monitoring Group), **Nout Wellink**, **Roel Campos** and **Stavros Thomadakis**.



Public Interest Oversight Board

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

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