International Federation of Accountants
545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

March 28, 2009

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors
Mr. Rakesh Mohan, Deputy Governor of the Reserve Bank of India
Mr. Tiff Macklem, Associate Deputy Minister, Canadian Ministry of Finance
c/o The G20 Secretariat
G20uk@hm-treasury.x.gsi.gov.uk

Re: Recommendations for Working Group 1 - Enhancing Sound Regulation and Strengthening Transparency

Dear Chairmen,

With the global economy in crisis, the G20 is uniquely situated to provide leadership and vision, and effect change to financial systems at an international level. This letter is in response to the G20's *Declaration from the Summit on Financial Markets and the World Economy* issued on November 15, 2008. It is designed to support G20 leaders with recommendations that assist in developing solutions that lead to a more stable financial system.

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession. IFAC is comprised of 157 members and associates in 122 countries and jurisdictions.[1] Through them, we represent approximately 2.5 million accountants in public practice, education, government service, industry, and commerce. IFAC, through its independent standard-setting boards, and in conjunction with the international regulatory community, sets international auditing and assurance, ethics, education, and public sector accounting standards. IFAC also issues guidance to encourage high-quality performance by professional accountants in business.

We believe that the accountancy profession will have an essential role to play in resolving the current crisis and in building a reformed international financial system. Therefore, IFAC would like to support the G20 in its work in facilitating change throughout the world. In doing so, we are submitting separate letters (of which this is one) to three of the four G20 Working Groups. In each letter, we provide recommendations in response to the general objectives stated in the G20's *Declaration from the Summit on Financial Markets and the World Economy*, issued on November 15, 2008.

[1] For a list of professional accountancy institutes from G20 nations with membership in IFAC please refer to *Appendix A* of this letter.

Please advise us should you require further information or supporting detailed proposals on any of the recommendations made in this document. We would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting to bring about the needed changes in the international financial system.

Sincerely,

Ian Ball

Ian Ball
Chief Executive Officer

Summary of the Recommendations to Working Group 1

1. We recommend that the G20 countries adopt International Standards on Auditing (ISAs) where they have not already done so, and urge their adoption in nations and jurisdictions. This will assist:
   (a) the G20's goal of strengthening transparency and accountability in the context of the audit of financial information; and
   (b) national and jurisdictional regulatory systems in the interpretation and exchange of audited financial information.
2. We recommend that the G20 countries adopt and implement (in letter and spirit) the Organization for Economic Cooperation and Development's (OECD) *Principles of Corporate Governance* as the standard framework for corporate governance, and urge its adoption in other nations and jurisdictions.
3. We recommend that the G20 countries act to ensure that sufficient resources are applied to develop and disseminate implementation guidance for all global standards that they adopt/support, such as ISAs, the OECD's *Principles of Corporate Governance*, the International Financial Reporting Standards (IFRS), and all others of the Financial Stability Forum's (FSF) Compendium of Standards.
4. We recommend that the G20 call for the establishment of an international, principles-based threshold of competencies for senior financial officers in public interest entities. This should emphasize, *inter alia*, training in corporate ethics, knowledge and application of financial reporting standards, continuing professional development, and familiarity with the national governance codes, and other regulatory rules and procedures.
5. We recommend that the G20 consider reforms of enterprise risk management systems and senior corporate remuneration schemes, as both may adversely affect sustainable business performance.
6. We recommend that the G20 advocate the implementation of high quality models of governance for all international institutions with mandates to set financial regulation. Such models should be built upon principles of public oversight, accountability, independence and transparency – all of which are in the public interest.
7. We recommend that the G20 countries adopt International Public Sector Accounting Standards (IPSASs) where they have not already done so, and urge their adoption in other nations and jurisdictions.
8. We recommend that the G20 acknowledge the importance of the small business sector and ensure that any agreed policy actions are supportive of this sector.

The following section expands on the recommendations summarized on the previous page for purposes of Working Group 1:

1. **We recommend that the G20 countries adopt International Standards on Auditing (ISAs) where they have not already done so, and urge their adoption in other nations and jurisdictions. This will assist:**
   (a) **the G20's goal of strengthening transparency and accountability in the context of the audit of financial information; and**
   (b) **national and jurisdictional regulatory systems in the interpretation and exchange of audited financial information**

Assisting the G20's Goal of Strengthening Transparency and Accountability in the Context of the Audit of Financial Information

The global adoption of ISAs[2] will improve the quality and consistency of the audit of financial information. The FSF includes ISAs as one of the twelve key standards for sound financial systems. The FSF stresses the importance of ISAs for the following:[3]

- To strengthen domestic financial systems by encouraging sound regulation and supervision;
- To provide greater transparency;
- To provide more efficient and robust institutions, markets, and infrastructure;
- To provide international financial stability by facilitating better-informed lending and investment decisions;
- To improve market integrity; and
- To reduce the risks of financial distress and contagion.

In this context, the global adoption of ISAs will also contribute to reducing the costs associated with differing sets of standards. These costs result from the following:

- Lack of comparability of audits across multiple jurisdictions;
- Lack of transparency due to differences among regulatory disclosure regimes from country to country; and
- Information asymmetries and economic uncertainties resulting from lack of comparability and transparency.

Information asymmetries that result from the lack of convergence hinder the acceptability of the auditor's assessment between countries and across different financial sectors, e.g., banking, securities and insurance, thereby having some impact on systemic risk.

Currently, more than 100 jurisdictions around the world use ISAs, or base their national standards on them; however, some key capital markets have yet to accept them. The global

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[2] ISAs are developed by the International Auditing and Assurances Standards Board (IAASB), an independent standard-setting board under the auspices of IFAC and subject to oversight by the Public Interest Oversight Board.

[3] Financial Stability Forum; *Compendium of Standards*, April 28, 2008; www.FSForum.org.

adoption of ISAs will likely facilitate greater transparency and result in higher standards of accountability.

Assisting National and Jurisdictional Regulatory Systems in the Interpretation and Exchange of Audited Financial Information

The current crisis has inspired many calls for regulatory reform and re-regulation of financial sectors at both the national and international levels. If regulation is to be considered among the remedies for the crisis, it must facilitate intergovernmental cooperation, closer institutional linkages and international policy integration. The global adoption of ISAs will assist regulatory processes in the following ways:

- Providing centrality – a single concept of the audit for use by global regulatory institutions;
- Assisting the convergence of oversight regimes across nations and jurisdictions;
- Narrowing the gaps left by "regulatory asymmetries," which arise from the differences in the scope and nature of laws as well as the level of scrutiny required for financial information itself among jurisdictions. This reduces possibility for regulatory arbitrage; and
- Providing efficiency benefits for developing countries that have not yet created comprehensive sets of standards for auditing.

The global adoption of ISAs is also consistent with monetary and economic policy integration efforts within and beyond the European Union. It will reinforce existing initiatives, including the *Basel Accords*, the widespread adoption of IFRS, the convergence of Generally Accepted Accounting Principles (GAAP) and IFRS, and the adoption of the International Organization of Securities Commissions' (IOSCO) objectives and principles of securities regulation.

Should the G20 require further information or supporting detailed proposals concerning the adoption and implementation of ISAs, IFAC would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting.

2. **We recommend that the G20 countries adopt and implement (in letter and spirit) the Organization for Economic Cooperation and Development's (OECD) *Principles of Corporate Governance* as the standard framework for corporate governance, and urge its adoption in other nations and jurisdictions.**

IFAC supports the OECD's *Principles of Corporate Governance* (which is among the Financial Stability Forum's Compendium of Standards) as the standard framework of corporate governance in nations and jurisdictions. The G20 should require adoption of the OECD's principles and advocate for their universal use:

- The OECD's *Principles of Corporate Governance* are designed to strengthen corporate governance practices in companies around the world. They urge strengthened transparency and disclosure to protect investors and to strengthen capital markets. The OECD's principles are a critical element of the international financial system. Convergence to a common set of principles benefits investors and other stakeholders. IFAC agrees with the OECD's assertion that corporate governance is a key element of improving economic efficiency and growth, and strongly supports the position that corporate governance practices internationally should be based on the principles. The OECD's principles also emphasize that auditors should be accountable to shareholders, not management, and that boards of directors should effectively oversee the financial reporting function, ensuring that appropriate systems of control are in place.

- In February 2009, IFAC's Professional Accountants in Business (PAIB) Committee released International Good Practice Guidance, *Evaluating and Improving Governance in Organizations*, which will help professional accountants in business and their organizations to improve further their governance structures and processes – something critical to ensuring an organization's viability and accountability. This guidance is designed to complement the OECD's *Principles of Corporate Governance*, by encouraging organizations to achieve a balance between conformance with rules and regulations on one hand and driving stronger organizational performance on the other.

Additionally, IFAC encourages additional research to support further the OECD's recent conclusions about the crisis as put forward in its document *Corporate Governance Lessons from the Financial Crisis*. Those reasons include the following:[4]

- "Risk management systems have failed in many cases due to corporate governance procedures rather than the inadequacy of computer models alone: information about exposures in a number of cases did not reach the board and even senior levels of management, while risk management was often activity rather than enterprise-based. These are board responsibilities."
- "Remuneration systems have in a number of cases not been closely related to the strategy and risk appetite of the company and its longer term interests."
- "The importance of qualified board oversight, and robust risk management including reference to widely accepted standards is not limited to financial institutions."

Finally, IFAC encourages the G20 to consider carefully the corporate governance implications of the large ownership positions taken by Governments in their attempts to stabilize the financial system.

Should the G20 require further information or supporting detailed proposals concerning the corporate governance implications of the large ownership positions taken by Governments or the International Good Practice Guidance issued by its Professional Accountants in Business Committee, IFAC would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting.

[4] The Organization for Economic Cooperation and Development; *Corporate Governance Lessons from the Financial Crisis, OECD Steering Group on Corporate Governance*; Corporate Affairs Division, Directorate for Financial and Enterprise Affairs; February, 11, 2009; p. 3.

3. **We recommend that the G20 countries act to ensure that sufficient resources are applied to develop and disseminate implementation guidance for all global standards that they adopt/support, such as ISAs, the OECD's *Principles of Corporate Governance*, the International Financial Reporting Standards (IFRS), and all others of the Financial Stability Forum's (FSF) Compendium of Standards.**

It is essential that global standards are understood and applied consistently by individual corporations, auditors, regulators, and public and oversight authorities. Adoption and implementation of new rules and regulations will have a positive impact on the strengthening of the global financial architecture only if they are applied broadly and consistently. Many measures can address this solution. Among these, we would recommend the following for all global standards:

- They should be subject to detailed review processes to ensure that they are understandable, clear, and capable of consistent application;
- They should be able to be translated into multiple languages with consistent meaning; and
- Seminars from global bodies, such as those offered to banking and insurance supervisors by the Financial Stability Institute, should be actively promoted and supported by the G20 countries for worldwide audiences.

In respect to detailed review processes, the G20 should request that standards for all financial sectors should undergo drafting initiatives to ensure that they are understandable, clear, and capable of consistent application, implementation and translation. Doing so will enhance the quality and uniformity of how such standards are interpreted and implemented worldwide.

The International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board (IESBA), independent standard-setting boards under the auspices of IFAC and subject to the oversight of the Public Interest Oversight Board, will complete intensive projects to "clarify" their standards in 2009. In each case, this effort involved broad public discussions with key regulators and authorities such as IOSCO, the Basel Committee on Banking Supervision, the European Commission, the World Bank, the International Association of Insurance Supervisors, and others.

Clear and unambiguous standards result in consistent application and enforcement around the globe. Clarification initiatives should be designed to assist national regulatory bodies, legislators and users of the standards. They also assist the development (or updating) of inspection or oversight policies, and related internal training programs. Clear and unambiguous standards provide the basis for higher quality translations into multiple languages.

Finally, we recommend that the G20 support intensive and extensive educational programs from leading global bodies. These sessions should have as their focus bringing together professional colleagues from around the world to share information and provide guidance on the implementation of international standards.

Should the G20 require further information or supporting detailed proposals concerning implementation guidance for its standards in auditing and assurance, ethics, education and public sector accounting, IFAC would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting.

4. **We recommend that the G20 call for the establishment of an international, principles-based threshold of competencies for senior financial officers in public interest entities. This should emphasize, *inter alia*, training in corporate ethics, knowledge and application of financial reporting standards, continuing professional development, and familiarity with the national governance codes, and other regulatory rules and procedures.**

Nations and jurisdictions differ in terms of the expectations, practices and cultural environments that determine the qualifications and levels of experience required for senior financial officers and others charged with primary responsibility for financial reporting in publicly traded companies and other public interest entities. IFAC encourages the G20 to consider the need for a universal, principles-based threshold of competencies for senior financial officers. This would establish between countries a common expectation and understanding of the role of the financial statement preparer. In the case of cross-border stock exchange registrants, such a basis of common competencies would enhance investor confidence. It should contain, *inter alia*, the following:

- Training in ethics – to foster a universal understanding of how senior financial officers should maintain integrity, objectivity, due care, confidentiality, and professional behavior;
- Knowledge and application of financial reporting standards to ensure that they are applied correctly;
- Continuing professional development – to ensure that senior financial officers and high level financial statement preparers remain up-to-date in the areas of their responsibilities; and
- Familiarity with the national corporate governance codes, (and other) regulatory rules and procedures – to guarantee, to the best extent possible, that compliance with the local regulatory regime is met.

All member organizations of IFAC, in over 100 countries and jurisdictions, are obliged to apply standards of ethics that are no less stringent than those contained in the *Code of Ethics for Professional Accountants* (the Code). The Code requires accountants to adhere to five fundamental principles: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior (through compliance with relevant laws and regulations and avoidance of any action that discredits the profession). All professional accountants in business, academia, and government belonging to IFAC member organizations are required to comply with this code.

Should the G20 require further information or supporting detailed proposals concerning the establishment of an international, principles-based threshold of competencies for senior financial officers in public interest entities, and the adoption and implementation of the IFAC *Code of Ethics for Professional Accountants*, IFAC would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting.

5. **We recommend that the G20 consider reforms of enterprise risk management systems and senior corporate remuneration schemes, as both may adversely affect sustainable business performance.**

IFAC highlights the following two governance issues that have arisen in this financial crisis (and previous financial crises) that call for reform:

- The first issue is aligning key executive and board remuneration with the longer-term interests of the company and its shareholders (OECD *Principles of Corporate Governance*, VI. Responsibilities of the Board). Enhanced disclosure and clarity of key executive and board remuneration in annual reports can help improve investors' understanding of the alignment of their remuneration with the long-term interests of the organization. A mechanism used in some jurisdictions, such as the United Kingdom, to allow investors greater influence over board and executive remuneration is to have shareholders approve all new (long-term) incentive schemes. Such shareholder involvement in remuneration, particularly with principal shareholders and investor advocates, might be encouraged in all major capital markets. As a minimum, the G20 has a significant role to play in helping to ensure that companies and their boards reconsider how to reward long-term performance, including identifying compensation schemes that reward the creation of sustainable value.
- The second issue is that effective and efficient enterprise risk management should form an integral part of an organization's governance system. In many organizations, risk management and internal control have (a) focused on the prevention of physical and financial loss at an operational level, and (b) been far removed from the strategic decision-making process**.** The need to better link risk management to corporate strategy is an important theme that should be recognized in all corporate governance codes and requirements. Sometimes referred to as an enterprise risk management framework, such an approach draws together all the elements required to integrate the management and consideration of risk with the management of the business. In both these areas, there does not appear to be a shortage of good practice guidance but rather a failure to follow good practice and to embrace issues in spirit rather than in letter.

6. **We recommend that the G20 advocate the implementation of high quality models of governance for all international institutions with mandates to set financial regulation. Such models should be built upon principles of public oversight, accountability, independence and transparency – all of which are in the public interest.**

The current crisis has inspired many calls for regulatory reform and re-regulation of financial sectors on an international level. All international institutions with mandates to set financial regulation must be based on models of governance built upon public oversight, accountability, independence, and transparency.[5] They must contain structures and processes that operate and are seen to operate in the public interest, in a context in which there are needs for legitimacy,

[5] Note: For further information on IFAC's position on governance arrangements for standard setting, see http://www.ifac.org/Store/Details.tmpl?SID=1229098401517900&Cart=1229099307518379, *International Standard Setting in the Public Interest,* an IFAC position paper issued on December 8, 2008.

independence, transparency, performance (encompassing technical competence, responsiveness and efficiency), and accountability.

- Public interest – unless appropriate structures and processes for governance and public oversight, and appropriate levels of transparency, are instituted, the public interest will not be protected.
- Independence – independence in fact and in appearance is essential to a standard setter. Independence, in the standard setting context, refers to freedom from inappropriate pressure, from whatever source, in decision-making in respect of a standard.
- Transparency – transparency is central to the functioning of any regulatory institution, and should be reflected in many elements of its structure and processes. Due process for such institutions should include public access to documents and proceedings, public commentary on policy development, and a public oversight structure.
- Legitimacy – this is achieved, in part, through independence, which is critical. However, for there to be legitimacy, there must also be high levels of transparency, appropriate levels of performance from the standard setter, and accountability of the standard setter to stakeholders, especially the international regulatory community.
- Accountability – there must be clearly established mechanisms to hold the regulatory body accountable, both individually as members and collectively as a board. There must also be appropriate accountability arrangements for other parts of the process, such as the public oversight body. As part of this, issuance of public reports and other documents should also occur on a regular basis.
- Performance – an effective regulatory body needs to achieve both independence and performance. While independence is essential, the performance of a regulatory body is enhanced if there is an appropriate representation of those with current or recent technical knowledge and hands-on experience in the application of the regulations. Performance also encompasses efficiency and responsiveness.
  - Efficiency refers both to economic efficiency in relation to regulations being produced (benefits exceed costs) and productive efficiency in the process itself.
  - Responsiveness relates to the requirement that the process must enable new standards, or revised standards, to be produced in a timely fashion in the event of changed circumstances. It also refers to the need to listen and respond appropriately to concerns by stakeholders and others affected by the standard setting process.

Should the G20 require further information regarding high quality, transparent regulation in the public interest; we would welcome the opportunity to share our experience, which is outlined in a recently issued position paper entitled *International Standard Setting in the Public Interest*.

7. **We recommend that the G20 countries adopt International Public Sector Accounting Standards (IPSASs) where they have not already done so, and urge their adoption in other nations and jurisdictions.**

In the current crisis, where significant government financial actions are being taken, the need for transparency in government financial reporting is critical for economic recovery. Taxpayers and citizens are entitled to information that allows them to hold governments accountable for the use of public resources, including the extent to which current deficit positions are sustainable, and whether balance sheets are strong enough to withstand further external shocks, not to mention meeting current obligations associated with long-term trends like an aging population. Governments, like companies, need timely and accurate financial information to monitor and manage their performance.

IPSASs are designed to apply to the general-purpose financial statements of all public sector entities. They are developed primarily for the accruals-based accounting context to assess the impact of fiscal and monetary policy decisions; assist external reporting by governments to electorates, taxpayers and investors; and assist in internal management decisions in resource allocation (planning and budgeting), monitoring, and accountability.

Should the G20 require further information or supporting detailed proposals concerning the adoption and implementation of IPSASs, IFAC would welcome the opportunity to contribute to the activity that will be needed subsequent to the April 2 G20 meeting.

8. **We recommend that the G20 acknowledge the importance of the small business sector and ensure that any agreed policy actions are supportive of this sector.**

While we understand that the G20's primary focus is on macroeconomic initiatives, reform of regulation, and the international financial architecture, we are concerned that the small business sector is not directly acknowledged nor scoped into the work of any of the Working Groups. It is important to stress that this sector has been hit especially hard by the credit crisis and, moreover, in most countries and industries, it is small business that will be the primary source of new jobs, innovation and growth. Accordingly, we believe that the G20 should acknowledge the importance of the small business sector and ensure that any agreed policy actions are supportive of this sector. In particular, we encourage the G20 governments to consider the possible flow-on effects on small business of further regulation, and seek to ensure that the impact on this sector is not disproportionate.

Appendix A

List of Professional Accountancy Institutes from G20 Nations with Membership in IFAC

Argentina

- Federación Argentina de Consejos Profesionales de Ciencias Económicas

Australia

- CPA Australia
- The Institute of Chartered Accountants in Australia
- National Institute of Accountants in Australia

Brazil

- Conselho Federal de Contabilidade
- Instituto dos Auditores Independentes do Brasil

Canada

- The Canadian Institute of Chartered Accountants
- Certified General Accountants' Association of Canada
- CMA Canada

China

- The Chinese Institute of Certified Public Accountants

France

- Compagnie Nationale des Commissaires aux Comptes
- Conseil Supérieur de l'Ordre des Experts-Comptables

Germany

- Institut der Wirtschaftsprüfer
- Wirtschaftsprüferkammer

India

- The Institute of Chartered Accountants of India
- The Institute of Cost and Works Accountants of India

Indonesia

- Indonesian Institute of Accountants or Ikatan Akuntan Indonesia

Italy

- Consiglio Nazionale dei Dottori Commercialisti e Degli Esperti Contabili

Japan

- The Japanese Institute of Certified Public Accountants

Mexico

- Instituto Mexicano de Contadores Públicos, A.C.

Russia

- The Institute of Professional Accountants of Russia
- Russian Collegium of Auditors

Saudi Arabia

- Saudi Organization for Certified Public Accountants

South Africa

- The South African Institute of Chartered Accountants
- The South African Institute of Professional Accountants

South Korea

- Korean Institute of Certified Public Accountants

Turkey

- Expert Accountants' Association of Turkey
- Union of Chambers of Certified Public Accountants of Turkey

United Kingdom

- The Association of Chartered Certified Accountants
- The Chartered Institute of Management Accountants
- The Chartered Institute of Public Finance and Accountancy
- The Institute of Chartered Accountants in England & Wales
- The Institute of Chartered Accountants of Scotland

United States

- American Institute of Certified Public Accountants
- National Association of State Boards of Accountancy