

IFAC Policy Position Paper #4

**A Public Interest Framework for the
Accountancy Profession**

REQUEST FOR COMMENTS

The International Federation of Accountants (IFAC) approved this Exposure Draft of IFAC Policy Position Paper #4, *A Public Interest Framework for the Accountancy Profession*, for publication in November 2010. This exposure draft may be modified in light of comments received before being issued in final form. **Comments are requested by March 25, 2011.**

Respondents are asked to submit their comments **electronically** through the IFAC website (www.ifac.org), using the “Submit a Comment” link on the Exposure Drafts and Consultation Papers page. Please note that first-time users must register to use this new feature. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website. Comments can also be faxed to the attention of the Senior Technical Manager, Regulation & Public Policy, at +1 (212) 286-9570, or mailed to:

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Introduction

All professional organizations must consider the notion of the *public interest* while seeking to advance the interests of the professions they serve. Any attempt to balance these forces invites a variety of practical challenges; however, in the evolution of any profession such an exercise is likely necessary from time to time as societies and marketplaces change in scope and complexity.

The *Public Interest Framework* presented in this paper enables the International Federation of Accountants (IFAC), professional accountancy organizations and others the means to better evaluate whether the public interest is being served through the actions of the profession and its institutions. It is designed to provide policymakers, regulators, and business leaders with the means to more consistently assess many of the issues currently debated at the national and international levels.

IFAC considers that the “public interest” is the common benefit that all citizens share from the services provided by the accountancy profession.¹ The “public” should be inclusive of all individuals and groups because the responsibilities of the profession impact every aspect of society: consumers, suppliers and taxpayers. The responsibilities of the profession are designed to protect certain “interests” of the public. These interests include, amongst many others, the soundness of financial reporting, the comparability of financial information across borders, fiscal prudence in public expenditures, and the contributions that accountants make to corporate governance and organizational performance.

Without further specification of how the term “public interest” is given effect, references to the term are vague and non-operational statements. To address this gap, we apply a definitional framework comprising three criteria: 1) consideration of costs and benefits for society as a whole; 2) adherence to democratic² principles and processes; and 3) respect for cultural and ethical diversity. This framework provides criteria for formulating public policy positions for the profession, benchmarking the appropriateness of new regulation, developing professional standards, and evaluating public interest issues.

The Public Interest Framework: Three Criteria

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

1. Consideration of costs and benefits for society as a whole
2. Adherence to democratic principles and processes
3. Respect for cultural and ethical diversity

¹ By “accountancy profession” we refer to IFAC members and associates, which are primarily national professional accountancy bodies, and their members, who comprise approximately 2.5 million accountants employed in public practice, industry and commerce, government, and academia across more than 120 countries and jurisdictions.

² By the term “democratic,” we refer to the notion of fair, balanced and inclusive participation in decision-making.

The 1st criterion requires us to assess the public interest in terms of negative and positive outcomes (costs and benefits) for society as a whole, recognizing that the accountancy profession through its actions has an impact on people, organizations, capital markets, and governments. The 2nd criterion requires us to assess a decision or action taken in the public interest as a democratic process—something which must contain certain qualities of governance, public participation, and public accountability. The 3rd criterion requires us to assess the extent to which any public interest issue or policy can be applied appropriately and interpreted consistently from one society or jurisdiction to the next.

In general, we argue that the public interest is not served unless all three criteria are met, at least to some degree. However, it must also be recognized that the three criteria may not always be met to the same degree, in which case determining what is in the public interest involves a balance, or trade-off, between the three.

When speaking specifically about accounting firms, which range from small and medium practitioners to large, global networks, we acknowledge the need for scalability in all three criteria. In the same way, consideration for scalability should also be seen in the context of organizational size and capacity for business enterprises and other entities.

Scalability in the Public Interest Framework

It is important to stress that the costs of applying the public interest criteria above should be proportional to the importance of the matter under consideration. Thus, a “scalable” approach should be applied to take into account the time, manpower, and resources involved in assessing actions or decisions against the three criteria. Cost/benefit analyses could often imply an extent and rigor of analysis which far outweigh the benefits of the analysis and is disproportionate to the importance of the issue under consideration. In the same way, we must consider rational, efficient approaches when striving to conform to democratic principles, for example when setting up governance structures, processes, and mechanisms.

Who is the “Public” and What are its “Interests”?

We consider that the public interest is the sum of the benefits that citizens receive from the services provided by the accountancy profession, incorporating the effects of all regulatory measures designed to ensure the quality and provision of such services.

Who is the “Public?”

The “public” includes the widest possible scope of society: individuals and groups of all jurisdictions sharing an international marketplace for goods and services. All levels of society are affected, directly or indirectly, by the activities and responsibilities of the accountancy profession. This includes all consumers and suppliers in the global economy, regardless of the size of the enterprise or group.

The “public” includes all users of financial information and decision-makers in the financial reporting supply chain: financial preparers, corporate boards, stakeholders, auditors, governments, and financial industries (e.g., banking, insurance, legal, and investment services). It also includes electors and taxpayers, who as citizens of local, regional, and national jurisdictions, are affected by

the fiscal decisions of their respective governments for public expenditures and the distribution of public resources.

What are its “Interests?”

In the broadest respect, “interests” are all things valued by society. These include rights and entitlements, including property rights, access to government, economic freedoms, and political power. Interests are things we seek to acquire and control; they may also be ideals we aspire to, and protections from things that are harmful or disadvantageous to us. However, we extend our definition of “interests” to describe more specifically the responsibilities that professional accountants have to society. Examples of these responsibilities include:

- Providing sound financial and business reporting to stakeholders, investors, and all parties in the marketplace directly and indirectly impacted by that reporting;
- Facilitating the comparability of financial reporting and auditing across different jurisdictions;
- Reducing economic uncertainty in the marketplace and throughout the financial infrastructure (e.g., banking, insurance, investment firms, etc.);
- Requiring that accounting professionals apply high standards of ethical behavior and professional judgment;
- Specifying appropriate educational requirements and qualifications for professional accountants;
- Encouraging governments and public sector organizations to provide their constituencies with sound fiscal information and decision-making; and
- Providing professional accountants in business with the knowledge, judgment, and the means to contribute to sound corporate governance and performance management for the organizations they serve.

The 1st Criterion: Consideration of costs and benefits for society as a whole

The 1st criterion requires us to assess the public interest in terms of negative and positive outcomes or “costs and benefits” for society as a whole. Cost/benefit analysis is the formal process of evaluating the negative and positive outcomes of a particular action, policy, or condition to determine whether or not (and the extent to which) positive outcomes outweigh negative ones. Costs and benefits can be assessed in both quantitative and qualitative terms. Quantitatively, they are measured in numerical terms (e.g., cost in dollars, human casualty rates, or acres of depleted rainforests). Qualitatively, they are measured in terms of opinions and judgments, which are often collected through interviews or surveys. For example, while we can establish the cost of a major investment project for an organization, we may not be able to express quantitatively the impact that the project may have on staff morale. Thus, while cost/benefit analysis serves as a critical public interest criterion, it is limited by the things which cannot be measured with quantitative certainty. In this respect, it should reinforced by other public interest criteria.

It is important to distinguish the application of cost/benefit analysis in a societal context from the project or investment appraisal undertaken by individual organizations seeking to maximize profit or capital gain. It is feasible for an action to have a positive net benefit for a company,

while it has a net cost to society as a whole. In this public interest context, this criterion refers to the impact on society as a whole, rather than to the company. It is an assessment of whether or not a policy, action, or marketplace condition does more good to the public than harm.

Additionally, cost/benefit analysis should be followed by some form of post-implementation review or process used to evaluate the effectiveness of policies or actions taken. This is to assess whether those policies or actions have fulfilled their intended purpose, and the extent to which costs and benefits were accurately determined. Post-implementation review also provides information into how such policies or actions can be further modified for improvement and concludes the cycle for cost/benefit analysis.

Finally, all cost/benefit analyses and post-implementation reviews should be proportional to the importance of the matter under consideration (see section titled *Scalability of Public Interest Framework* on p. 3). Cost/benefit analysis can be a significant undertaking in terms of time, manpower, and other resources. As the significance of an action or decision (and the associated implications for the public interest) become greater, so too does the extent of investment in cost/benefit analysis.

The 2nd Criterion: Adherence to democratic principles and processes

The 2nd criterion requires us to assess the public interest in terms of process. The criterion involves considering the extent to which democratic principles are incorporated into the policy design, governance and implementation of decisions and actions. For the accountancy profession, these decisions and actions include, for example, those associated with the development of laws, with regulatory and compliance systems, and with standard-setting. Any institution or publicly-established body designed to protect or facilitate a public interest objective should adhere to democratic principles and processes. These principles and processes include:

- **Adherence to due process**—The accurate, consistent observance of established procedures of governance and operation. Due process provides the public with a concise blueprint, documented in a charter or similar format, of how those entrusted with authority must exercise it. This in turn provides an important mechanism for public accountability.
- **Independence**—All individuals as well as regulatory, standard-setting or public oversight bodies should be independent from special interest groups, political pressures or societal forces that can have undue influence over their responsibilities to the public. The independence of such bodies should be built into their design and composition, incorporated into their procedures of due process, and ensured by their funding arrangements. All individuals should act independent from personal interests.
- **Fair and Balanced Representation in decision-making**—In addition to all regulatory, standard-setting and public oversight bodies being independent, there should also be the assurance that such bodies are comprised of individuals that represent a full, balanced range of stakeholders or constituencies of the public. This can be guaranteed by a predetermined allocation of seats (and their respective votes) based on factors such as professional specialization, gender, or geographical region. This also includes mandating a balance between technical and non-technical representatives; the latter's presence ensuring wider public participation.

- **Opportunity for public consultation**—This process provides for greater inclusivity in the design of public policy by involving the participation of a wide range of opinions and expertise. It also allows for greater transparency by providing the public with insights into how policymakers approach the design of policy.
- **Public accountability mechanisms**—These are processes designed to ensure that public organizations meet their obligations to their stakeholders and society at large. Examples include transparency and public oversight. Transparency is the process of making things such as meeting minutes, voting records, and financial statements accessible to the public. Public oversight is a form of check-and-balance whereby one body is appointed to monitor the due process, independence and performance of another body.
- **Consideration of environmental impacts**—policymakers must consider the role that environmental impacts have on the public interest. These impacts include changing economic conditions (e.g. financial crisis), significant shifts in public values and the collapse of major institutions. Such impacts can affect public values, the regulatory environment as well as the priorities of government and society.

It is critical for individuals and groups at all levels of society to possess confidence in the accountancy profession as an element in the efficient functioning of markets and the legitimacy of their regulatory mechanisms. Legitimacy is maintained by adherence to the established rules and processes of governance. It is also maintained by those entrusted with power acting appropriately and within the values of society. Thus, by adhering to democratic principles as a public interest criterion, legitimacy and public confidence in the accountancy profession are protected.

The 3rd Criterion: Respect for cultural and ethical diversity

The 3rd criterion requires that differences in cultures and ethical systems should be considered in assessing whether or not the public interest is being served, especially where institutions are operating in an international environment. Culture and ethics vary from one society to another. Yet a global interpretation of the public interest must be based on universal values. Cultural and ethical systems influence how each society regards the costs and benefits of a public interest issue. They also determine how each society approaches the procedural aspects of policymaking and the extent to which democratic principles and processes are considered appropriate. These differences may be based on the following:

- The role of historical forces and how they influence each country in terms of political ideology, trade alliances and regional economic cooperation.
- Differences in legal and judicial systems (e.g. common law, civil code and Islamic law), which in turn shape our notions of how legislation is created and interpreted, how policy is made, and the extent to which courts and other government bodies are independent of one another.
- The variety of concepts that shape each society's notions of political power, individual and economic freedoms.
- The extent to which ethnic or religious customs shape legal and commercial systems. These include client expectations, contractual terms among parties, and business practices.

- The level of economic development may have an impact on public interest assessments. For example, in developing countries the resources required to implement professional regulation may not be available due to other more pressing needs in society.

For the development of a global marketplace for accountancy services, organizations that work with the profession (e.g., governments, regulatory bodies, standard-setters and professional institutes) must consider different interpretations of the public interest as a part of the policymaking process.

The 3rd criterion illustrates the cultural factors that hinder or assist cooperation among institutions working with the accountancy profession. Both international and national institutions may have competing or conflicting views of what constitutes the public interest. The cooperation between institutions will depend upon the extent to which they share or can evolve toward similar public interest values.

IFAC's Application of the Public Interest Framework

IFAC's mission is to serve the public interest. To achieve this, IFAC and its independent standard-setting boards develop international standards on ethics, auditing and assurance, education, and public sector financial reporting. IFAC also issues guidance to support professional accountants in business, small and medium practices, and the development of the profession in developing nations. In each of these areas, IFAC needs to consider all three public interest criteria. In this sense, the public interest criteria acts much like a filter between the mission of IFAC and its work. The following examples illustrate how the public interest framework is reflected in the work of IFAC:

- **The Public Interest Oversight Board (PIOB)**—IFAC's three standard-setting boards³ and its Compliance Program⁴ are under the independent oversight of the PIOB, which was established in 2005 as an integral part of a set of governance reforms. The PIOB reinforces the adherence to democratic principles in the work of IFAC and the Public Interest Activity Committees (PIACs).⁵ IFAC's governance arrangements for its standard setting functions, as well as the nominating process for appointments to the PIACs are under the oversight of the PIOB, which observes all meetings of relevant boards and committees, monitors due process and provides consultation when necessary.⁶
- **Principles-Based Professional Standards**—The standards produced by the IAASB, IAESB, IESBA and IPSASB are principles-based. International Standards on Auditing (ISAs), International Education Standards (IESs), International Public Sector Accounting Standards (IPSASs) and the Code of Ethics for Professional Accountants are articulated in clear, concise language accessible to and broadly applicable in diverse ethical systems and

³ The three standard-setting boards under oversight of the PIOB are the International Auditing and Assurances Standards Board (IAASB), the International Accounting Education Standards Board (IAESB), and the International Ethics Standards Board for Accountants (IESBA).

⁴ IFAC's Compliance Advisory Panel (CAP), which is responsible for the Compliance Program is also under the oversight of the PIOB.

⁵ The Public Interest Activity Committees include the IAASB, the IAESB, the IESBA, and the CAP.

⁶ The public interest implications of IFAC's governance arrangements are explained in IFAC Policy Position Paper #3, *International Standard Setting in the Public Interest* (December 2008), which is available at <http://web.ifac.org/publications/ifac-policy-position-papers-reports-and-comment-letters>.

cultures throughout the world. These standards are also developed under a system of due process that contains oversight of the PIOB and input from each board's consultative advisory groups (CAGs).⁷ With the completion of the Clarity Project in 2009, the IAASB has issued its auditing standards in a form designed to enhance the understanding and implementation of them, as well as to facilitate translation and uniformity throughout the world. Capital markets will benefit from the improved applicability of the clarified auditing standards which are also designed for more accurate translation into other languages and their respective cultures.

- **Impact Analysis**—IFAC is currently developing an Impact Analysis process for the development of professional standards. While IFAC's process is based primarily on a qualitative approach, it contains methods similar to cost-benefit analyses and regulatory impact assessments used by governments and other organizations for developing public policy and ensuring that regulatory action is justified, appropriate, and cost-effective. Impact Analysis will contribute to the development of high-quality standards by providing a systematic and structured approach to obtaining information about the effects of a proposed new standard on relevant stakeholders. Impact Analysis also documents and communicates this information as part of its due process.
- **Standard-Setting and Small and Medium Enterprises (SMEs)**—In developing the Clarified International Standards on Auditing (ISAs),⁸ the International Auditing and Assurances Standards Board (IAASB) provides guidance indicating that certain aspects of the audit will vary with the size, complexity and nature of the entity. Specific SME considerations address how to apply the ISAs in small entities. Whether there is a one auditor or a team of auditors, the Clarified ISAs address these considerations to help remind auditors of the characteristics that are relevant so that the work performed is done in an appropriate context.⁹

Conclusion

The concept of the public interest is critical to the work of IFAC. In this paper, we provide a definitional framework that is central not only to our work, but to that of institutions within the global accountancy profession.

At the core of our definition, we assert that the *public interest* is the benefit that all citizens share from the services provided by the accountancy profession, including all regulatory measures designed to ensure the quality and provision of such services. We expand upon this to identify the “public” as being inclusive of society at large. The accountancy profession has a responsibility to protect certain “interests” of society, which include among other things the soundness of financial reporting, the comparability of financial information across borders, fiscal prudence in public expenditures, and the contributions that accountants make to corporate

⁷ The CAGs consist of external public sector and private sector institutions that provide the standard setting boards with technical advice and input regarding agendas.

⁸ On February 27, 2009, the Clarity Project reached its completion when the PIOB approved the due process for the last several clarified ISAs. Auditors worldwide now have access to 36 newly updated and clarified ISAs and a clarified International Standard on Quality Control (ISQC 1).

⁹ See for more guidance on ISA application to SMEs/SMPs, web.ifac.org/download/Module_-_Clarified_ISAs.doc

governance and organizational performance. To assess whether or not we are acting in the public interest, we apply a framework of three criteria to policies or actions under evaluation: 1) consideration of costs and benefits for society as a whole; 2) adherence to democratic principles and processes; and 3) respect for cultural and ethical diversity. With scalability in mind, this public interest framework allows us to verify and gauge the extent to which any public policy issue can be addressed.

Ultimately, the definitional framework presented in this paper cannot definitively determine *what is in the public interest*; however it does provide the means to consider the question more systematically and with greater depth. This enables us to consider and address, with greater consistency, emerging issues as the accountancy profession continues to evolve.



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