

Standard Setting for Accountants and the role of the Public Interest Oversight Board

Law Working Paper N° 291/2015

May 2015

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ECGI Working Paper Series in Law

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Abstract

Standard setting for accountants and auditors takes place in international bodies, organised within the framework of the International Federation of Accountants. These are the International Standards on Auditing (ISAs) and the ethical standards. External oversight is exercised by the Public Interest Oversight Board, itself monitored by the international financial institutions. The setting of these standards is based on a balance between expert interests, in which professionals play an important role, and external oversight. These self-regulatory standards are addressed to accountants worldwide and are transposed and implemented nationally by different means (legislation, contract, professional associations).

Keywords: accountants, auditors, audit standards, ISA, public interest, PIOB, IFAC

JEL Classifications: K22, M40

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Although the PIOB has now published nine annual reports, its organisation and functioning is still not widely known. The purpose of this contribution is to analyse some aspects of the role of the PIOB. Much attention will be paid to the basic Agreements on which this three level structure has been built: the 2003 Agreement and the 2008 MG Charter¹.

1. The standard setting for accountants.

When in 2003 the present standard setting structure was introduced, the need was felt to upgrade the status of the previously existing professional standards from purely self-regulatory instruments implemented by the IFAC member bodies, to widely recognised and used professional standards with a higher public interest status due to external public oversight. By introducing external oversight, it was intended that public “confidence of the worldwide investor community and other stakeholders” -that had been severely shaken in the 2002-2003 major financial incidents² - would be restored and credibility of financial reporting enhanced. The basic philosophy on which this approach is based is that accountants – and especially auditors- critically contribute to public confidence in the financial markets and other related economic activities³ while on the other hand, investors and other stakeholders are entitled to have confidence in standards that would take into account the public interest, including their trust in the

* This paper has been written in personal capacity and does not necessarily reflect the opinion of the PIOB. [It aims to mark the 10th anniversary of the PIOB](#)

¹ Both documents can be consulted on the PIOB Website, under “constitutional documents”

² The new structure was a direct consequence of the insolvencies of Enron (2001) and Worldcom (2002) with losses amounting to \$74 and \$118 Bn respectively. In Europe, the Parmalat case should be mentioned.

³ See the Position of the European Parliament: “The public-interest function of statutory audit means that a broad community of people and institutions rely on the quality of a statutory auditor's or an audit firm's work. Good audit quality contributes to the orderly functioning of markets by enhancing the integrity and efficiency of financial statements. Thus, statutory auditors fulfil a particularly important societal role.” Position of the European Parliament adopted at first reading on 3 April 2014 with a view to the adoption of Regulation (EU) No .../2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC (Text with EEA relevance)
<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2014-0283+0+DOC+XML+V0//EN> ▶

published data. It was also hoped that more authoritative standards would be more readily adopted in different jurisdictions.

The outcome of the 2003 negotiations resulted in a quite complex organisational scheme based on a three layered structure, involving as a first layer, the accountancy profession represented by IFAC, on the other the interest of investors, markets and users of the accounts, embodied in the new oversight structure, while the third layer consists of the overall monitoring role exercised by the international financial institutions, ultimate guarantors of the public interest in this specific domain.

(i) The standard setting boards

The pre-existing Committee structure was maintained but modified in several respects: the new standard settings board (SSBs) ⁴ would draw on the experience of accountants and auditors – “practitioners” - with considerable professional practice, but also on the input from other professionals with experience and insights related to the audit activity and the profession, the “non-practitioners”. At least three members are designated as ‘public members’ standing for the broad public interest. This composition aims to achieve a balanced outcome, where all interests are taken into account, also on the basis of the extensive public consultation process. The chairperson is an independent personality⁵.

The whole standard setting process is fully transparent so as to inspire public confidence.

(ii) The PIOB

The second layer consists of the newly constituted Public Interest Oversight Board, overseeing different phases in the standard setting process with a view of insuring that standards will be properly responsive to the public interest.

Created in 2005, the PIOB was set up in Paris by the MG members, IFAC, its first 8 members and 2 observers. It was located in Madrid, next door to IOSCO in a building that was graciously made available by the Spanish government. Legally the PIOB is a board composed of internationally appointed senior civil servants, financial and accountancy experts. Due to its international nature, the board is a body created within a Spanish foundation that acts as its formal legal support. The PIOB is responsible for overseeing the public interest activities of IFAC related to auditing and financial statement assurance activities, with a special reference to standard setting in the area identified in the 2003 Agreement. It will oversee the activities of the three standard setting boards, but also of other bodies within IFAC such as the Nominating Committee or the Compliance Panel. These different bodies are designated “IFAC public interest activity committees” or PIACs. The original documents largely identified these bodies with the IFAC, it is only in the more recent years that a clear separation of the SSBs from IFAC has been put forward: these are now designated by IFAC as the Independent

⁴ The IAASB (International Auditing and Assurance Standards Board), the IESBA (International Ethics Standard Board for Accountants) and the International Accounting Education Standards Board (IAESB); see [http:// ifac.org/ audit-assurance](http://ifac.org/audit-assurance);

⁵ This is the case for the IAASB and for the IESBA.

Standard Setting Boards. The notion of independence was not part of the original set up although some provisions pointed in the direction of independence.

The 2003 Agreement also contained some of the essential rules of organisation of the PIOB: its members will be appointed by the MG members at that time acting individually, the selection of the chair, the board size (maximum 10 members), their terms of office (2 times 3 years). A strict code of ethics applies, pursuant to the requirement that “members shall not be in public practice as auditors or working for a firm that performs audits”. Members once appointed cannot be revoked by the MG, but the PIOB itself can remove a PIOB member for “poor performance, conflicts of interest, dishonesty and otherwise not acting in the public interest”⁶.

PIOB members are referred to as “senior individuals of integrity and high reputation with an interest and knowledge of the international issues relevant to the auditing and assurance function and of the role of such functions in the global capital markets” but – except for one member who will be recommended by IFAC to the nominating committee - without recent actual auditing experience⁷. Members should have “the ability and desire to serve the public interest in an independent and unbiased manner”. Their independence will be guaranteed by the provision that they shall agree to serve the interest of the public as a whole, not the interest of their respective nominating bodies.

As to its functioning, the PIOB should conduct its activities meeting high standards of transparency. It will be funded for 50% by IFAC, while the MG members “may provide contributions to support” the PIOB. At present funding is insured by IFAC (for about 50%), the European Commission (for about 20%), MG members and other contributors. It reports on its activities in an annual public report, and through its website⁸.

(iii) The Consultative Advisory Groups

The CAGs or Consultative Advisory Groups are advisory bodies composed of organisations that have a direct interest in the accountancy profession and its activities. There is a CAG for each SSB. Their composition is very wide, allowing opinions from all stakeholders to be reflected. The IAASB and the IESBA CAGs meet twice a year formulating the opinions of stakeholders on the proposals submitted to the SSBs. Their advice relates to a wide range of issues such as agenda, work program, priorities, and the draft standards discussed in the SSB. Their comments are submitted to the SSBs which reply by indicating how these remarks have been taken into account, or not. The consultation process is therefore clearly structured and is the basis of the due process assessment that guarantees the quality of the standards. It is overseen by the PIOB.

The CAG chair takes part in all meetings of the SSB. He is also heard at PIOB meetings.

(iv) The Monitoring Group

⁶ § 2.7 of the 2003 Agreement.

⁷ 8 out of 10 members of the present PIOB have audit experience, according to their published biographies.

⁸ See www.PIOB.org

As a third layer, the Monitoring Group (MG) is composed of the international financial institutions that lie at the basis of the reform and continue to monitor the development of the standard setting. It is composed of the main stakeholders in the process of regulation and standard setting for accountants, i.e. IOSCO, the World Bank, the Financial Stability Board, the Basel Committee and the International Association of Insurance Supervisors, the European Commission and the International Forum of Independent Audit Regulators (IFIAR). The members of the MG have a privileged dialogue with the standard setting boards, exposing the needs of the sectors they are engaged in and for which they bear ultimate responsibility. The admission in 2013 to the MG of IFIAR expresses the increasing importance of audit regulators in their function of audit inspectors, and contributes to high quality implementation of the standards by the international auditing profession but also feeds into the standard setting process

These institutions have a primary interest in pursuing the policy objectives of the reform i.e. building confidence in the accountancy profession and its activities to ensure that the world's financial markets and institutions can rely on the quality of the financial data that lie at the basis of myriad economic and financial decisions. In today's terminology one should add that their action also aims at worldwide financial stability and the avoidance of financial crises that have proved to be so destructive. This objective can be pursued by several means, in the present case by developing high quality standards and practices in the fields of auditing and assurance. But at the same time, the wide acceptance of these standards contributes to global convergence, supporting innovation and creating job opportunities and mobility.

The MG has a general monitoring function covering the entire structure. Its overall mission consists of "supporting the development and issuance of high quality international standards with a view of converge, and engage with national bodies"⁹. The MG's action addresses on the one hand the PIOB as an organisation, on the other "consults and advises the PIOB with respect to regulatory, legal and policy developments that are pertinent to the PIOB's public interest oversight"¹⁰.

In practice, the MG members directly address the SSBs by sending numerous comment letters on standards under consideration, relating to both policy and technical issues. They can also have their position formulated in the regular advisory process being represented on the CAGs. Remarks by the MG or its members should be given "strong consideration" by the SSB concerned, when applicable stating the reasons why the remarks have not been taken on board.

As far as the PIOB is concerned, the MG appoints its members, evaluates its operations, approves its budget and more generally gives input to its overall policies and decisions. At the regular meetings with the PIOB, the MG draws attention to issues for the PIOB to be followed up, assessing its effectiveness, discussing subjects of general interest but also explaining its views even on technical matters.

(iv) Overall assessment of the standard setting structure

⁹ See § 3.1, 2003 Agreement

¹⁰ See 2008 MG Charter

This scheme represents a unique example of worldwide standard setting and has proved to be exceptionally successful. It is well known that, in the absence of a Treaty based international authority such as the WTO, developing standards or regulations applicable on an international scale is particularly difficult and often disappointing. Its success is based on the unique conjunction of the needs of the accountancy profession, the expectations of the markets and business firms for reliable and internationally comparable accounting and auditing guidelines and finally the seal of acceptance by the bodies with authority in the field of finance.

2. The role of the PIOB in the standard setting process

(i) The functioning of the PIOB

The PIOB functions as a college meeting four times a year. It is usual at these meetings that the chairs of the standard setting boards and of the CAGs present the activities of their boards for the last period and develop the issues in the draft standards that are submitted to the board. IFAC leadership, i.e. the IFAC chairperson and CEO, accompanied by the managing director informs the PIOB on the organisational issues and on the ideas or proposals to adapt the functioning of the SSBs. Taking into account this information, the PIOB deliberates on the proposed standards and discusses the wider issues raised by the standard setting process. Decisions are adopted by simple majority, or by a 2/3rd majority for exceptional items¹¹. After each meeting, the PIOB reports in a press release on its activities for the last three months.

Following up on a reference in the 2003 Agreement that its members would observe the meetings of the SSBs, one of the PIOB's first decisions consisted in delegating one of its members to the meetings of the SSBs, the CAGs and other IFAC meetings. This technique of "direct observation" was controversial at a certain time, but is still followed for most of today's meetings. It has revealed itself as a powerful instrument to better understand the debates in the SSBs, the motives for the options taken and the way the debates are evolving. The method has since been refined: not all meetings are physically observed, but only the most critical ones, as mentioned in the Public Report. Some meetings are observed by PIOB staff, in some cases on a remote basis. Members do not only observe, they regularly intervene during the session when public interest matters have to be exposed to the SSB, in some cases resulting in changes in the procedures, or in the options taken by the SSB. At the end of the process, the PIOB determines whether due process has been followed, and whether the standard reflects the public interest. If this is not the case, e.g. if it considers that the proposed standards did not meet the public interest, the PIOB requests the matter to be taken up by the SSB within a certain time period.

The PIOB is in charge of several other building blocks in the standard setting process:

¹¹ The removal of the chair of a SSB; the extension of its oversight to other public interest activities of IFAC.(2.4). These topics would have to be discussed with the MG (3.1 of the 2003 Agreement)

it approves the terms of reference of the different SSBs, , and further oversees their work programs and priorities. These will include duties and scope of the work, charter and operating procedures.

The PIOB plays an important role in the procedures leading to the appointment of members of the SSBs: members are appointed by the IFAC board, on the basis of a selection effectuated by the Nominating Committee, composed of IFAC members (Chair, CEO, etc) with the PIOB present in an observer capacity. Candidates for nomination are solicited on the basis of a worldwide call, whereby candidates' names will be put forward by an IFAC member organisation. The PIOB will approve the nomination process for the members of each of the PIACs, on the proposal of the IFAC. The same applies to setting the number of members in an SSB, the qualifications of the members or the composition of the nominating committee. Their appointment and that of the SSB chair¹² will be subject to PIOB approval.

The PIOB with a 2/3rds vote may also request the removal of an SSB chair for "good cause". It has access to all documentation relating to public interest activities, including standard setting activities. It will evaluate due process on the basis of the reports it receives from IFAC on the operation and effectiveness of these procedures

Funding of the functioning of the PIACs, including the SSBs is ensured by IFAC, the PIOB evaluating its adequacy. This would include adequate staffing.

(ii) The PIOB's mission to act in the Public interest

In the concept of the 2003 Agreement, the PIOB is not in charge of detailed supervision of the standard setting process: the Agreement is quite clear that the PIOB is not acting in a management or operational role, leaving the drafting of the standards to IFAC, in to-days formulation to the SSBs. The same applies to the planning of the SSBs activities, where the PIOB can request a matter to be added to the work agenda, or to take up a particular project. Interesting is the prohibition for the PIOB to be involved in the activities of the Public Sector Committee, later named the International Public Sector Accounting Standards Board (IPSASB). The matter has been submitted to the MG in 2012, and it was decided that "the composition of the MG and of the PIOB was not well suited for IPSAS governance" ¹³. As a consequence IFAC has organised a separate oversight body.

There has been some misunderstanding as to what is the real mission of the PIOB, and whether it is limited to the verification of "due process", or whether this verification includes the more general objective of serving the public interest. The interpretation has changed over time¹⁴.

The 2003 Agreement created, under the heading "Public Interest Oversight Board", a body that will be in charge, as its title indicates, to oversee the public interest. It is

¹² The 2003 Agreement only mentioned the IAASB chair. This regime has been extended to the three standard setting boards. The IAASB chair has been designated full time, the IESBA chair part time.

¹³ See PIOB, 8th Public Report, p. 7

¹⁴ PIOB, 5th public report p. 7

referred to as a “key reform”. Its mission is further explained as follows: “The objective of the PIOB is to increase 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.*” And further: “PIOB is responsible for overseeing the public interest activities of IFAC....”.¹⁵ The MGs mission is to “ monitor the execution by the PIOB of its mandate”. Several statements in the 2008 MG charter refer to this task of the PIOB: the MG will consult and advise the PIOB with respect “to regulatory, legal and policy developments that are pertinent to the PIOB's public interest oversight”. Similar references are found in the MG Charter: “The PIOB was created as part of that reform (i.e. the 2003 reform) to ensure that public interest is properly taken into account by the PIACs standard settings process”. The MG monitors how the PIOB is carrying out its public interest role in the reform process with particular regard to the PIOB’s oversight of the standard setting process¹⁶. This analysis does not deny the importance of due process as an instrument that the PIOB can use to ensure balanced standards setting, to ensure that the views of all stakeholders have been sought and taken into consideration. But due process in itself does not guarantee the public interest to be achieved.

The texts of these two fundamental Agreements establish clearly that the PIOB has the right, beyond and apart from due process oversight, to take a stand on public interest issues, whether these have been mentioned in the public consultations or not, in order to ensure the public interest responsiveness of standards. The role of the PIOB to protect the Public Interest cannot be made dependent on remarks made during the consultation process. It should be remarked that differently from national consultations, due to the diversity of interests and views, worldwide consultations very often do not reflect all concerns that may be considered relevant from the angle of the public interest. It is then the task of the PIOB to draw attention to these points.

The PIOB has applied this reading of the public interest concept: in its Seventh Public Report, it stated that “respect for due process may not always guarantee the public interest”¹⁷ In subsequent consultations consultees – especially from the non – professional side - clearly supported the idea of the PIOB focusing on the public interest¹⁸.

Remains the question what has to be understood by “the public interest”, a notion that although used in many legislations (e.g. competition, product standards, bank supervision and resolution, to name a few) is generally not defined in the law, nor in specific governance codes, but is strongly related to the context in which the issue arises. “Public interest” is used as a criterion to define the higher priority to be reserved to issues that touch on the welfare of the wider public. In its 6th public report the PIOB

¹⁵ 2003 Agreement § 2.1

¹⁶ MG Charter 2008 § A.1

¹⁷ PIOB, 7th Public Report, p.5 (2012)

¹⁸ See the 2012 Public consultation, Responses of Regulators, Standard Setting Boards and other Public Bodies, PIOB Website Public Consultations; add: Conclusions from the Public Interest Workshop, September 11, 2014 on: PIOB Website, Public Consultations; PIOB, 8th Public Report, pp 8 and 9 (2013).

published a tentative analysis of the notion of Public Interest, applying it to the specific subject of the accountancy profession. It points to the multidimensional nature of the public welfare notion leading to aspects such as financial, political, social, environmental aspects, while in the case of accountancy services, it is the financial welfare that would prevail. The contribution to the public interest by the accountancy profession could be summarized by pointing to its contribution to public confidence in public account-related information.

In two recent cases the PIOB deemed that the standard setting work that was presented for adoption was unfinished and that additional work was needed on aspects that in its judgment were closely related to the public interest.

But in the end, in each concrete case, the interpretation should be determined on the basis of its own characteristics, taking into account the interest of the relevant public. This is also the lesson to be learned from judicial decisions applying the “public interest” test especially in the field of competition law.

3. The implementation of the international standards for accountants

It may seem trivial to repeat that drawing up standards is easy, having them adopted at the national level is much more difficult, but having them effectively applied in accountancy work is real hard, but essential. The standards developed by the SSBs are unique in their class, as being international, worldwide standards developed by a professional organisation but serving as a model, and a source of inspiration for both legal transposition and use within the professional context.

The standards as developed by the SSBs are essentially self-regulatory statements: they are established by a non-authoritative body, based on the insights and experiences of members of the profession concerned and due to be transposed or implemented by the members of the Federation through their local implementation procedures. As part of the membership conditions, national accountants' organisations are obliged to ensure transposition of the standards. In order to ensure better credibility to the standards, they were subjected to an external check as to their compatibility with the public interest: this is the additional blessing administered by the PIOB. Transposition and implementation of the standards is still one of the essential building blocks of this system of regulation. Within IFAC a special committee is dedicated to this task and to the multiple implications that it contains: the Compliance Advisory Panel or CAP¹⁹

Theoretically, the transmission of the standards as established by the SSBs into the national legal system may take several avenues. On the one hand, several jurisdictions have introduced into their legal system detailed provisions relating to

¹⁹ <http://www.ifac.org/about-ifac/membership/compliance-program/compliance-advisory-panel>; see: Self-assessment information about the regulatory and standard-setting framework in their countries (Part 1) and their organizations' activities in addressing IFAC's membership requirements (Part 2) as described in the Statements of Membership Obligations: <http://www.ifac.org/publications-resources/statements-membership-obligations-smos-1-7-revised>

auditing and assurance or to conduct of business that have a formal legal standing in that jurisdiction. On the substance of the standards, however, national regulators have often sought inspiration in the IFAC standards, or more exceptionally have refused to do so, adopting a system that is sometimes considerably different from the IFAC pattern. The reasons for the latter attitude are diverse: often it is considered that the international standard is not adapted to the local legal regime, in other cases it is because the international standard does not reflect the higher expectations existing in these jurisdictions.

The auditing and assurance standards as applied in the US and in the EU can be cited as examples of this approach. While the US has developed their own standards²⁰, the European case is an interesting example of the process of acceptance of the international standards as developed by the IAASB. Article 26(1) of the directive 2014/ ... states that “member states shall require statutory auditors and audit firms to carry out statutory audits in compliance with international audit standards adopted by the Commission”. International audit standards are the ISAs as issued by the IAASB. These standards will be followed in the fields of “audit practice, independence and internal quality controls” Adoption by the Commission requires that a certain number of conditions are met, among which especially that they “ have been adopted with proper due process, public oversight and transparency, and are generally accepted internationally”, but also “ are conducive to the Union public good”. One can expect that on this basis the ISAs will become applicable within the 28 EU member states, but with some –hopefully – slight amendments.

In other jurisdictions recognition by the legislature, or by virtue of a delegation granted by the legislator will result in similar effects: the standards will be transposed in national law, with or without modifications, but ultimately their nature will change as far as their legal position is concerned: from an associative, essentially contractual standard, it will become a legal obligation, enforceable in court of law, and possibly triggering liabilities even to third parties (e.g. for misrepresentation).

Another technique of making the standards applicable is based on an agreement between the world largest audit firms: these firms have agreed to apply the audit and ethical standards in all audits they will perform, at least to the extent that this would not be contrary to local law. The result is that the agreement raises the level of the standards to the “international level of professionals”, a criterion that could become relevant in court cases.

Comparable is the contractual technique whereby the auditor refers to standards in his audit report declaring that the IESBA Ethics Code has been followed. This approach is now followed in the recent standard on auditor reporting²¹.

²⁰ The PCAOB Standards are applicable to the Public Interest Entities, and approved by the SEC. For other entities the standards are set by the AICPA.

²¹ See for the formulation in: Illustration I, ISA 700 Revised: it is “assumed that the relevant ethical requirements that apply to the audit comprise the International Ethics Standard Board for Accountants “Code of Ethics for professional accountants” together with the ethical requirements relating to the audit in the jurisdiction and to which the audit refers”.

The fourth technique is based on the associative mechanisms within IFAC. The International Federation of Accountants is a grouping of accountants' associations from around the world. The standards are addressed to the national member organisations which are legally obliged on the basis of their association agreements with IFAC to endeavour to transpose the standards in their own jurisdictions, normally in their by-laws, or internal regulations. Where applicable this association should strive the standards to be introduced by way of official regulation. In the absence of official recognition, transposition and enforcement of the standard would essentially be in the hands of the association. Most of the time, its effect would be limited to the members of the association, but third party effects (e.g. in terms of liability) might be included. It is this form of transposition that is the subject of considerable efforts undertaken by IFAC, and organised within the Compliance Advisory Panel. On the basis of a detailed monitoring, the CAP verifies and encourages the transposition in all countries where IFAC member organisations are active. This is a long term and time consuming effort, but awareness about the importance of this matter grows in many jurisdictions.

4. Conclusion

The standard setting system as was created by the 2003 Agreement is based on a subtle balance of professional and public interest considerations. The presence of experienced professionals in the standard setting board has been a driving force in developing this considerable body of standards, and other normative instruments. This balance has to be preserved to avoid the perception that the professional interests have received priority and that the standards do not sufficiently take into account the wider societal interest.

There is the overarching concern about the effectiveness of the accountancy profession in avoiding major, or even not so large, dysfunctions in the economy. Expectations are high, perhaps too high, but at least relying on the information coming from the Audit inspections, the work is not finished. This concern relates not only to standard setting, but mainly seems to relate to enforceability and implementation of existing standards. All involved in this ambitious effort to make the world financially safer should not wait for the next major collapse of public confidence to start acting in their respective fields of competence.

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