



February 8, 2018

The Monitoring Group
c/o International Organization of Securities Commissions
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By e-mail: MG2017consultation@iosco.org

Dear Sirs

**Monitoring Group Proposals to Strengthen the Governance and Oversight
of Audit-related Standard Setting in the Public Interest**

This letter is written on behalf of, and with the approval of, the International Ethics Standards Board for Accountants (IESBA).

Introduction

The IESBA recognizes that it is important that there should be periodic, thorough reviews of the way organizations with a public interest responsibility, such as standard-setting bodies, discharge their responsibilities. For that reason, the IESBA welcomes the review undertaken by the Monitoring Group.

The Monitoring Group Consultation Paper comes at a time when, in response to calls from stakeholders, the IESBA has just finalized a complete restructuring of its *Code of Ethics for Professional Accountants* (the Code). That restructuring has enhanced the clarity, usability and enforceability of the Code for all professional accountants. In doing so, the IESBA developed the holistic approach taken in the Code to ensure that the ethical responsibilities of professional accountants, whatever their role or function, are complementary and mutually supportive.

The restructured Code also includes significant improvements to, for example, the conceptual framework and the safeguards in the Code, the provisions addressing threats created by the long association of audit personnel with the audited entity, and professional accountants' obligations on encountering non-compliance or suspected non-compliance with laws and regulations. The restructuring project was undertaken with the full support and with extensive input from the regulatory community, including the Public Interest Oversight Board (PIOB).

Whilst the consultation process is being undertaken, the IESBA will continue to progress its existing agenda. In particular, the IESBA will:

- Undertake a full review of the Code's provisions addressing non-assurance services provided by auditors to those entities they audit;
- Determine whether the concepts underlying professional skepticism should apply to all professional accountants; and

- Consider the ethical implications of technological developments with respect to the whole accountancy profession.

Over recent years, the IESBA has been working to achieve the objectives identified in the Consultation Paper and to improve its operating procedures. It believes it has made significant progress, albeit that there will always be room for improvement. In the course of these developments, the IESBA has coordinated to an increasing extent with other international standard-setting boards, notably the International Auditing and Assurance Standards Board (IAASB) and the International Accounting Education Standards Board (IAESB).

The IESBA's primary submissions

In developing its response to the Consultation Paper, the IESBA has taken the view that its primary submissions should focus on the particular proposals that will directly impact its remit – namely the development of a global Code of Ethics for professional accountants.

In this context, the IESBA's overarching concern is that the proposal to create a single board – with responsibility for both (i) standards for audit and (ii) standards for ethics, but for auditors only – is misconceived.

There are three principal reasons for that view:

1. It is not in the public interest to split the Code.

Ethics, and therefore ethical standards, is one of the key attributes that define a profession.

Strong, respected ethical standards that apply to all professional accountants, irrespective of function, demonstrate the value and importance of the accountancy profession as a whole. That, in turn, makes the profession attractive to the brightest future entrants, thereby ensuring a strong profession in the public interest.

This holistic approach to the development of ethical standards for professional accountants is increasingly important as available data show that many professional accountants, having qualified with a firm and then undertaken one or more forms of professional activity, will in due course leave professional practice for a career in industry. At present, a person who does so is expected to comply with the Code – including, in particular, the fundamental principles and provisions relating to conflicts of interest and professional behavior – irrespective of the nature of his or her work.

For these reasons, the IESBA believes that it is in the public interest that an ethical framework for the accountancy profession is developed on a holistic, integrated basis.

This approach has been supported by members of the Monitoring Group, who have publicly subscribed to the philosophy that, while auditing is an important safeguard to financial reporting quality, that quality also depends on strong ethical values being observed by those involved in the preparation of financial and other reports. In that context, members of the Monitoring Group – including the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision and the World Bank – have emphasized the importance of strengthening and developing the provisions in the Code addressing the responsibilities of professional accountants in business.

Consistent with this view, the existing Code adopts an integrated approach – addressing the responsibilities of auditors, other professional accountants in public practice and professional accountants in business. At the same time, in accordance with the principles of better regulation, the Code recognizes that different, proportionate, considerations, particularly with respect to auditor independence, apply to public interest entities and entities that are not public interest entities.

The benefits of this integrated approach can be seen in two key areas.

- The existing Code requires all professional accountants, whether preparers of financial statements or auditors, to comply with the fundamental principles. Both, therefore, have the same ethical responsibilities – so avoiding different expectations of the behavior and responsibilities of professional accountants undertaking different roles in the financial reporting supply chain (e.g. as preparer, internal auditor, external auditor, director or audit committee member), and therefore avoiding public confusion.

The alignment of expectations of all those involved promotes higher quality financial reporting. The approach proposed by the Monitoring Group would place primary responsibility on auditors – which is inappropriate given that the primary responsibility for a company's financial statements rests with management or those charged with governance. Indeed, preparers are the first line of defense against corporate malfeasance.

- The sections of the Code governing how professional accountants discharge their ethical responsibilities when they encounter actual or suspected non-compliance with laws and regulations have different, but complementary, provisions that ensure an effective outcome in the public interest.¹

If such an alignment of ethical standards for all professional accountants is to be achieved under the Monitoring Group's proposals, there would need to be a process for securing general agreement with multiple bodies that set ethical standards for professional accountants around the world. That process would need to address the individual legal and regulatory circumstances that apply from country to country and would, inevitably, be more complex and time-consuming than the existing process. A failure to achieve general agreement around the world would result in professional accountants having to apply multiple codes of ethics that will either overlap or have gaps.

In the IESBA's view, the approach proposed by the Monitoring Group would risk leading some jurisdictions to revert back to setting ethical standards on a national basis – undermining the important public interest goal of establishing global standards. This would undermine the progress made to date – which has resulted in some 120 jurisdictions adopting the Code or using the Code as the basis for their national ethical standards.

For these reasons, the IESBA considers that the Monitoring Group's proposal that the merged Board's remit should be limited to ethical standards for auditors would materially undermine the effectiveness of the overall ethical framework and, therefore, be contrary to the public interest.

On the basis that one Board will continue to be responsible for setting standards for all professional accountants, it would be illogical, inappropriate and impractical to do so through a merged Board that would also be responsible for setting auditing standards.

¹ Once aware of actual or suspected non-compliance, the auditor is required by the Code to inform the management of the audit client of the auditor's concerns so that steps can be taken to investigate and address such non-compliance. Professional accountants in management are required by the Code to pursue the inquiries necessary to understand the position and then to take appropriate action to address or prevent such non-compliance. Both auditors and professional accountants in business are required to take action if the audited entity fails to respond appropriately. To separate the two would lead to gaps in the structure developed to address such circumstances.

2. The development of standards for audit and audit-related ethical standards should not be undertaken by the same Board.

The IESBA believes that establishing a Board with responsibility for standards for audit and audit-related ethical standards is misconceived for the following reasons:

- Given the fundamental importance of ethical standards in setting the values and behavior expected of all members of the accountancy profession, it is imperative that the development of ethical standards receives the same priority and attention as auditing and assurance standards.
- The development of ethical standards involves different considerations and methodologies, when compared with those that apply when developing auditing standards.

Auditing standards focus on the detailed process of carrying out an audit and provide extensive material on risk assessment, quality control and the procedures required to execute the different phases of the audit.

By contrast, ethical standards focus on the behavior expected of a professional accountant. Therefore, when setting ethical standards for global application, consideration needs to be given to cultural differences and to differences in the applicable laws and regulations in various jurisdictions.

- The development of auditing standards is so technically demanding, detail-oriented and time-consuming that it risks overwhelming the development of ethical standards (whether audit-related or for all professional accountants).

Against this background, the IESBA believes that it would be inappropriate to compress the skill sets required to develop both types of standards within one Board, and then expect the members of that Board to have the expertise, experience and diversity to discharge the merged Board's remit to the highest quality as required by the public interest.

3. Global applicability is a much greater challenge when setting ethical standards than it is when setting standards for auditing.

Setting ethical standards that secure global applicability involves taking account of a range of considerations. For example, there are wide differences in the behavioral characteristics around the world, whether as a result of differences in culture or the institutional norms prevailing in different countries. These considerations may also be exacerbated by the fact that the rule of law is of varying effect in certain parts of the world. In contrast, the process of performing an audit is largely the same from one country to another.

The IESBA is also concerned that it will be difficult, if not impossible, to achieve sufficient diversity and experience on a smaller, merged Board to ensure that, both in fact and appearance, there is effective consideration of these issues.

For these reasons, the IESBA believes that it is essential in the public interest that ethical standards should continue to be set by a separate, independent Board and that that Board's remit should include the setting of ethical standards for all professional accountants.

Finally, the IESBA hopes that the Monitoring Group will ensure that any future proposals will be:

- Accompanied by a Public Interest Framework together with proposals for the future funding of the international standard-setting Boards. Both of these will provide important insights into how the Monitoring Group expects the new Board(s) to operate. Both are also central to any attempt to address perceptions that the standard-setting Boards are not independent; and
- Supported by analysis that demonstrates how its proposals will, in fact, achieve their intended objectives, whilst retaining the strengths of the existing model.

Sincerely yours

A handwritten signature in black ink, appearing to read 'Stavros Thomadakis', written in a cursive style.

Dr. Stavros Thomadakis
Chairman

IESBA Responses to the Specific Questions Asked by the Monitoring Group

Q 1

Do you agree with the key areas of concern identified with the current standard-setting model? Are there additional concerns that the Monitoring Group should consider?

The Monitoring Group has identified three principal areas of concern – the independence of the standard-setting process, the importance of addressing the public interest, and the timeliness of standard setting.

The IESBA recognizes that these are essential determinants of an effective standard-setting structure and process – and, as explained in its covering letter, it believes that they are the basis on which the IESBA currently operates. In particular, the IESBA believes that it does, as a matter of fact, set standards (i) in the public interest, (ii) independently of any particular stakeholder group, and (iii) in an efficient manner having regard to its commitment to due process.²

In this context, it is appropriate to emphasize that the IESBA has significantly improved its modus operandi in the light of its experiences with certain challenging projects. It recognizes that there will always be scope for improvement, and so it is constantly challenging and re-thinking its approach.

Against this background, the IESBA believes that the Monitoring Group should ensure that any proposals it takes forward:

- strengthen the financial reporting system as a whole,
- whilst safeguarding the strengths of the current structure and the quality and credibility of the existing standards.

Q 2

Do you agree with the overarching and supporting principles as articulated? Are there additional principles which the Monitoring Group should consider and why?

The IESBA agrees that the principles articulated in the consultation paper are essential to an effective standard-setting process. Those principles should be directed at achieving high quality standards. Achieving high quality standards should be a central objective of any public interest framework.

However, in the case of ethical standards, the IESBA believes that an additional principle should be added – global applicability.

Q 3

Do you have other suggestions for inclusion in a framework for assessing whether a standard has been developed to represent the public interest? If so what are they?

Any framework for assessing whether a standard has been developed to represent the public interest should recognize, in addition to those considerations identified in the consultation paper, the importance of:

² If the criticisms of the existing arrangements are based on perception, the IESBA would urge the Monitoring Group to ensure that its proposals address that issue – and do not adversely affect the strengths of the current structure and the quality and credibility of the existing standards.

- Diversity throughout the standard-setting structure as well as in the standard-setting Board; and
- Due process, involving, among other matters, a consultation process that provides all interested stakeholders with an opportunity to comment together with an approval process that demonstrates that proper consideration has been given to all consultation responses.

The IESBA believes that that commitment to due process is:

- A major contributor to the development of high quality standards (by ensuring that all stakeholders have an opportunity to consider and comment on draft standards);
- The basis that enables the IAASB and IESBA to develop standards without the benefit of any legal or other authority to secure their adoption. The same would be true for any successor Board; and
- Fundamental to the preparedness of the profession and national standard setters to implement their standards.

Q 4

Do you support establishing a single independent board, to develop and adopt auditing and assurance standards and ethical standards for auditors, or do you support the retention of separate boards for auditing and assurance and ethics? Please explain your reasoning.

The development of auditing and assurance standards and ethical standards for auditors for global application involves very different skills and processes. The IESBA therefore believes that there should be two separate Boards – one Board that is responsible for setting auditing and assurance standards and another, separate Board responsible for setting ethical standards.

The IESBA believes that the Board responsible for setting ethical standards should do so for all professional accountants.

The IESBA's reasons for believing that it is essential that there should be a separate Board responsible for setting ethical standards for all professional accountants are set out in its covering letter.

Q 5

Do you agree that responsibility for the development and adoption of educational standards and the IFAC compliance programme should remain a responsibility of IFAC? If not, why not?

The IESBA believes that responsibility for education standards should be developed by an independent body under the oversight of the PIOB.

The IFAC compliance program – in particular, the current arrangements for the adoption of standards and the Code involving the obligations of IFAC Member Organizations – have been important contributors to the extensive adoption of standards issued by the IAASB and IESBA around the world.

Were these arrangements not to be retained, alternatives would need to be put in place to achieve global adoption by other means.

Q 6

Should IFAC retain responsibility for the development and adoption of ethical standards for professional accountants in business? Please explain your reasoning.

The IESBA does not believe that the development of ethical standards for auditors should be separated from the development of ethical standards for other professional accountants.

It believes that there should be one Board that is responsible for setting ethical standards for all professional accountants because:

- There are substantial advantages in setting ethical standards on an integrated basis addressing the positions of all professional accountants, irrespective of their roles. In particular, the quality of financial reporting is enhanced if all those involved in the financial reporting supply chain are subject to the same ethical expectations – e.g. preparers, internal auditors, external auditors, directors and those charged with governance; and
- The Monitoring Group's proposals involve multiple Boards setting ethical standards for professional accountants – one setting ethical standards for auditors; a separate IFAC body setting ethical standards for other professional accountants; and, potentially, numerous national bodies setting ethical standards for professional accountants in their jurisdictions. Multiple Boards will:
 - o Increase the potential for inconsistencies in ethical standards, leading to confusion and difficulties in their application, a heightened concern for transnational audits;
 - o Lead to a longer development process due to the need for collaboration between the different Boards responsible for ethical standards; and
 - o Make enforcement more complex and costly, particularly for bodies that have oversight responsibilities over both auditors and other professional accountants in their jurisdictions.

Q 7

Do you believe the Monitoring Group should consider any further options for reform in relation to the organization of the standard-setting boards? If so please set these out in your response along with your rationale.

The IESBA believes that the Monitoring Group should consider – and promote – a structure for standard setting that includes one Board with responsibility for setting ethical standards for all professional accountants (an approach that is not considered in the consultation paper). Its reasons are set out throughout this response to the Monitoring Group's consultation paper.

Q 8

Do you agree that the focus of the board should be more strategic in nature? And do you agree that the members of the board should be remunerated?

The IESBA agrees that it is essential that a Board should adopt a strategic approach both to the discharge of its remit and to the development of standards (as it believes is the case at present). However that should not be at the expense of careful consideration of the text of standards because the effectiveness of a standard and its enforceability depend on the clarity of that text.

The IESBA would be supportive of remunerating board members in ways that would enhance the prospects of recruiting high quality individuals from more diverse and deeper pools of candidates drawn from all stakeholder groups.

Q 9

Do you agree that the board should adopt standards on the basis of a majority?

On the basis that any board is composed of three distinct stakeholder groups as proposed in the Consultation Paper, the IESBA does not agree that standards should be adopted on a simple majority basis.

The IESBA believes that, where consensus is not achievable (which any well-chaired Board should seek to achieve), a standard should be adopted provided that it is approved by an enhanced majority.

Q 10

Do you agree with changing the composition of the board to no fewer than twelve (or a larger number of) members; allowing both full time (one quarter?) and part- time (three quarters?) members? Or do you propose an alternative model? Are there other stakeholder groups that should also be included in the board membership, and are there any other factors that the Monitoring Group should take account of to ensure that the board has appropriate diversity and is representative of stakeholders?

The IESBA believes that the appropriate model would involve two separate Boards.

On that basis, it believes that the considerations to govern the composition of the Board responsible for setting ethical standards should be:

- (a) The representation of key stakeholders. The stakeholders should include those identified by the Monitoring Group – regulators and those to whom the Code would apply, namely users (including preparers and those charged with governance), auditors and other accountants in public practice; and
- (b) Geographic (including cultural diversity), sectoral and gender representation, size of organization, and level of economic development to reflect the fact that ethical standards are developed for global application.

This suggests that a Board of at least 15 would be more appropriate.

The IESBA believes that a merged Board of 12 will have neither the capabilities nor the capacity to fulfil that part of its remit that relates to the setting of ethical standards. Such a merged Board would need to be significantly increased to ensure the necessary experience and diversity.

Q 11

What skills or attributes should the Monitoring Group require of board members?

Board members should, collectively, be able to contribute technical expertise and practical experience from the perspective of each stakeholder group, together with an established appreciation of the public interest and how to deliver it.

Q 12

Do you agree to retain the concept of a CAG with the current role and focus, or should its remit and membership be changed, and if so, how?

Yes. The CAG provides valuable input to the standard-setting process – for example, it provides an effective forum for exchange of views and discussion among stakeholders.

The membership of a CAG should be as comprehensive as possible – including representatives of international and regional organizations with an interest in ethical standards for the global accountancy profession.

Q 13

Do you agree that task forces used to undertake detailed development work should adhere to the public interest framework?

In principle (because the specific public interest framework has not been provided), task forces should adhere to the applicable public interest framework.

The IESBA notes that there is no reason to believe that that is not the case under the present arrangements.

Q 14

Do you agree with the changes proposed to the nomination process?

Yes – IESBA believes that if the PIOB is to be solely responsible for the nomination process, it will be important to ensure that the PIOB has a membership that includes representatives of a range of stakeholders and geographic constituencies.

Q 15

Do you agree with the role and responsibilities of the PIOB as set out in this consultation? Should the PIOB be able to veto the adoption of a standard, or challenge the technical judgements made by the board in developing or revising standards? Are there further responsibilities that should be assigned to the PIOB to ensure that standards are set in the public interest?

The IESBA agrees with the proposed role and responsibilities of the PIOB provided that:

- The PIOB's mandate and processes will be clear;
- Its operations will be transparent; and
- Its resources will be enhanced so that it can fulfil multiple roles, including oversight of different Boards, the nominations process, and management of the budgeting and funding of the resultant organization.

The IESBA does not think that the PIOB should be able to veto the adoption of a standard if:

- The standard-setting Board(s) are composed as proposed;
- The PIOB monitors progress and provides "regular and transparent feedback" to the standard-setting Board(s) (which would include any challenge to the technical judgments made); and
- The standard-setting Board(s) have undertaken a thorough consultation process.

For the PIOB to be able to veto a standard against the background described above would be to introduce a fundamental conflict between the PIOB's oversight role and the independent standard-setting responsibility of the standard-setting Board(s).

Q 16

Do you agree with the option to remove IFAC representation from the PIOB?

No. It is important that the PIOB should have multi-stakeholder representation from the key stakeholders. That should include the profession because it would be damaging to the process if the profession is seen to have no standing in the oversight of standard setting.

If the reform of the PIOB is intended to achieve stakeholder diversity, the exclusion of one representative from the profession is illogical – particularly as one representative on a Board of, say, nine cannot adversely impact that body or threaten its ability to act in the public interest.

Q 17

Do you have suggestions regarding the composition of the PIOB to ensure that it is representative of non-practitioner stakeholders, and what skills and attributes should members of the PIOB be required to have?

The IESBA believes that the composition of the PIOB should reflect the objective of multi-stakeholder representation that underpins the Consultation Paper. It should therefore be comprised of individuals drawn from those stakeholders who have a public interest responsibility, from those constituencies falling within the 'user' stakeholder group (namely investors, preparers, academics and those charged with governance), and from the profession.

The members of the PIOB should have, collectively, sufficient technical expertise and practical experience, particularly if the PIOB is to challenge the technical judgements made by a standard-setting Board, together with an established appreciation of the public interest and how to deliver it.

Q 18

Do you believe that PIOB members should continue to be appointed through individual MG members or should PIOB members be identified through an open call for nominations from within MG member organizations, or do you have other suggestions regarding the nomination/appointment process?

PIOB members should be identified through an open call for nominations. Those eligible for appointment should not be limited to those employed by or working for Monitoring Group member organizations because:

- That would exclude from appointment able and experienced individuals who may have moved into other positions unconnected with the accountancy profession – e.g. into other public interest or academic positions (that may be part-time); and
- Changes in employment status would result in a need for members to resign and for new appointments being made. That would adversely affect continuity in the oversight of the standard-setting Board(s).

Q 19

Should PIOB oversight focus only on the independent standard-setting board for auditing and assurance standards and ethical standards for auditors, or should it continue to oversee the work of other standard-setting boards (e.g. issuing educational standards and ethical standards for professional accountants in business) where they set standards in the public interest?

This is a matter for discussion between IFAC (assuming the other standard-setting Boards are established under its aegis) and the PIOB.

Q 20

Do you agree that the Monitoring Group should retain its current oversight role for the whole standard-setting and oversight process including monitoring the implementation and effectiveness of reforms, appointing PIOB members and monitoring its work, promoting high-quality standards and supporting public accountability?

Yes. It would, however, be appropriate to review the membership of the Monitoring Group on a periodic basis.

Q 21

Do you agree with the option to support the work of the standard-setting board with an expanded professional technical staff? Are there specific skills that a new standard-setting board should look to acquire?

Yes.

Q 22

Do you agree the permanent staff should be directly employed by the board?

By acting as the umbrella organization, IFAC makes a major – and generally under-appreciated – contribution to the standard-setting structure.

If the Monitoring Group's proposals proceed (and IFAC has no continuing role), the IESBA believes it would be important to ensure that the Board(s) are established under an overarching body having legal status and capacity. That would facilitate the establishment and administration of the new structure – in particular, when renting premises, employing personnel, raising funds etc. The IESBA does not consider that these should be the responsibility of the Board itself or its individual members.

Q 23

Are there other areas in which the board could make process improvements – if so what are they?

It should be noted that the IESBA and IAASB are already pursuing various initiatives to address the Monitoring Group's objectives. These include initiatives to:

- Enhance the strategic and technical coordination between the IAASB and IESBA to identify and resolve issues that affect both their respective standards.
- Enhance the strategic focus of deliberations, including improvement of the structure of staff papers and focusing board discussions on the most significant issues.
- Encourage staff to explore how to modernize processes and enhance efficiency, including through improved use of technology.

Q 24

Do you agree with the Monitoring Group that appropriate checks and balances can be put in place to mitigate any risk to the independence of the board as a result of it being funded in part by audit firms or the accountancy profession (e.g. independent approval of the budget by the PIOB, providing the funds to a separate foundation or the PIOB which would distribute the funds)?

The IESBA believes that steps can be taken to ensure the independence of any Board(s) established as contemplated in the Monitoring Group's consultation paper.

However, the IESBA believes that as multi-stakeholder Board(s) are contemplated in the consultation paper, the optimum arrangements should involve multi-stakeholder funding.

Q 25

Do you support the application of a "contractual" levy on the profession to fund the board and the PIOB? Over what period should that levy be set? Should the Monitoring Group consider any additional funding mechanisms, beyond those opted for in the paper, and if so what are they?

See the answer to Q24.

Q 26

In your view, are there any matters that the Monitoring Group should consider in implementation of the reforms? Please describe.

The IESBA is concerned that, when implementing any reforms, careful consideration is given to the transitional arrangements that are put in place so as to ensure effective continuity in standard setting and to maintain confidence in standards and the accounting profession.

In particular, it will be important to ensure that the projects being undertaken by the IESBA should continue and that progress is made to address the priority matters identified by stakeholders.

Q 27

Do you have any further comments or suggestions to make that the Monitoring Group should consider?

Not at this time.