

## PRELIMINARY VIEWS AS OF DECEMBER 1, 2017

### IFAC'S INITIAL VIEWS AND REACTIONS TO THE MONITORING GROUP CONSULTATION PAPER

Transparent, high-quality international standard setting for standards used by professional accountants is an essential part of the global financial architecture.

High-quality international standards, adopted and implemented around the world are of fundamental public interest.<sup>1</sup> They help promote and enhance the quality, consistency, and comparability of financial information; improve financial stability and promote capital flows; and play an essential role in small- and medium-sized entities' (SMEs) growth and financing.

For 40 years, IFAC has been committed to a global standard-setting system that is credible, inclusive, legitimate, and which produces international standards that are relevant, innovative, and responsive to meet the challenges of the future. Over this period, the accountancy profession has shown that it is the only truly global profession that has been effective in working, in the public interest, with regulators and governments to create and evolve a framework and governance structure for independent international standards development and adoption. This cooperation and collaboration is unparalleled. Much evidence supports the view that today's system works and works well.

To ensure that standard setting remains fit-for-purpose and meets the challenges of a digital age, IFAC supports periodic reviews that aim to ensure standard-setting arrangements meet the needs of a rapidly changing world, where technology-enabled advancements are impacting the way in which corporate reporting and auditing is done. IFAC strongly supports reforms that draw on the existing model's strengths and successes; that address clearly identified issues; that provide the most orderly, cost-effective, and lowest risk approach; and which will lead to better outcomes.

Since the first half of 2015, when the Monitoring Group (MG) initiated this latest review, IFAC has consistently offered its full support and collaboration to once again examine if and how the existing standard-setting arrangements should evolve. In that regard, the IFAC Board undertook a holistic review of standard-setting arrangements in 2015, which informed IFAC's 2016–2018 strategy. Potential reforms to the standard-setting model, based on this review, are described later in this paper.

IFAC has consistently requested that the MG convene all key stakeholders to evaluate the current model, and seek to address ways to ensure standards are relevant, timely, and enhance confidence in global economies. Unfortunately, this forum was never established.

#### **The Current Standard-Setting Model**

To fully understand and evaluate the proposals outlined in the MG Consultation Paper (CP), several integral points about the existing standard-setting model are highlighted. The current model:

- is premised on **collaboration between private and public sectors**, recognizing that the public interest is best protected when all stakeholders cooperate and exercise their public interest obligations. **The collaborative approach is now recognized as a key feature of good regulatory practice;**
- has robust checks and balances in place to ensure that **no single stakeholder can exercise undue influence** over the development of standards;
- has produced high-quality standards which are widely accepted, including by MG organizations, around the world. **More than 120 jurisdictions** have either directly adopted, or use International Auditing and Assurance Standards Board® (IAASB®) and International Ethics Standards Board for Accountants® (IESBA®) standards as the basis for their national standards with many incorporating them into legislation or adopting them directly as national standards;

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<sup>1</sup> In June 2012, IFAC issued Policy Position Paper 5, [A Definition of the Public Interest](#). In this paper, IFAC defines the public interest as *the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy*. In other words, in the context of standard setting, the net benefits of international standard setting are evident by the scale of global adoption and implementation. Procedural rigor employed in international standard setting includes a rigorous and transparent due process, comprehensive public consultation, independent public interest oversight, and checks and balances throughout the system to ensure that all stakeholder input is appropriately considered and no one stakeholder can exert undue influence on the process.

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- produces standards that:
  - are **applicable to a range of reporting entities**—listed and private, large and small—across a number of jurisdictions around the world; assist smaller and private entities to evolve into public ownership; and are used as a basis for auditing standards for the public sector; and
  - **focus on promoting audit quality—premised on auditor skills and professional judgment;**
- has a **stringent due process and independent public interest oversight over all aspects of standard setting, including the nominations process, providing transparency and accountability, and ensuring the public interest is protected.** Broad stakeholder input is elicited, including through direct dialogue with regulators and other key stakeholders, and comprehensive public consultation;
- involves IFAC, in the absence of funding from other stakeholders, providing funding support for the full cost of standard-setting boards (SSBs), which prepare their own budgets under active Public Interest Oversight Board (PIOB) oversight, with checks and balances in place to prevent **any actions by IFAC that could be perceived as influencing the strategy, work plans, or content of the standards;** and
- is complemented by IFAC's Compliance Program that effectively **drives the promotion of adoption and support for the implementation of international standards** in more than 135 jurisdictions around the world.

Importantly, IFAC's experience spanning these past four decades has helped it to appreciate the **very tangible differences between international standard setting and standard setting in a national context.** With no legal standing, the IAASB and IESBA must work to persuade national jurisdictions around the world through technical credibility, representativeness, responsiveness, and thoroughness of due process. Global representation and participation, including by national standard setters, is integral to its success. On the other hand, national authorities in most cases have legal authority to impose new rules.

### **Monitoring Group Consultation Paper and Proposals**

IFAC welcomes the topics raised in the MG CP—for example, consideration of the nominations process and a multi-stakeholder composition of SSBs. However, **IFAC does have concerns about a number of the MG proposals.** Significantly, the CP does not provide respondents a complete picture of what the MG envisages for standard setting—that is, fundamental elements of the model with respect to governance; funding; transition and implementation risks; and the roles of the MG and PIOB. In parts, the CP fails to accurately reflect the current arrangements and offers proposals that are contrary to the stated aims in the paper.

***IFAC's responses to the specific questions asked in the CP are detailed in Section A.***

***The Appendix to Section A clarifies several areas of the CP where there are unsupported and unclear statements made by the MG.*** Several of these items could be misleading or are asserting features of proposals that are contrary to the stated aims.

The MG proposals are predicated on **several debatable assumptions**, including that: (i) **only regulators can act in the public interest;** (ii) **the current standard-setting model does not fully satisfy a number of the principles outlined in the CP;** and (iii) **that acting in the public interest requires standards to be developed that not all stakeholders will agree with.**

IFAC is of the view that the fundamental restructuring contemplated by the MG has the potential to result in outcomes counterproductive to the MG's stated improvement goals. They have the potential to undermine the work of many years spent to advance the legitimacy and credibility of the international standard-setting process, and to have a negative effect on perceptions of independence; the timeliness and relevance of standards; and the ability of standard setting to meet the demands of a rapidly changing world. **The MG proposals:**

- **move away from a shared public-private public interest model that reflects many of the key principles of good regulation, to a pure regulatory model** that provides the regulatory community the potential to exert undue influence over the outcomes of standards development;
- **create a risk that more rules-based, prescriptive standards will be produced that remove professional judgment as a necessary element of audit.** This will result in standards that produce compliance-type audits

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against which inspections and assessments may be more readily performed, and which will be less likely to remain relevant over time in a rapidly changing world. By removing the exercise of professional judgment, it puts at risk advances in audit quality that have been achieved over time and may stifle the ability to attract talent to the auditing profession;

- **create significant risks:**
  - **of the prospect of jurisdictions deciding to revert to more national-based standard setting and jurisdictional amendments to standards**—especially those jurisdictions where principles-based standards are valued and where standards are used for audits across a broad range of entities—thereby unraveling the tremendous achievements of international standard setting over the last 40 years; and
  - **to the ongoing relevance of standards as they do not recognize the significant challenge to current auditing standards from digital analytics and other technological developments** at a time when the development of auditing standards will be severely disrupted through the transitional period of change being proposed;
- **fail to recognize the important role played by PIOB in safeguarding the public interest by overseeing all aspects of standard setting, including the entire nominations process.** The PIOB approves all appointments to SSBs, and approves their strategies, work plans, and budgets; however, the CP does not explain why the existing arrangements are unable to safeguard public interest;
- **create a standard-setting model that is potentially significantly more costly—and less cost-effective—than current arrangements.** The MG proposes that the PIOB will require a significant increase in funding; that all SSB members will be remunerated; that an entirely new legal entity in an entirely different location be established; and that there be a significant increase in the number of permanent technical staff;
- **indicate that funding from the global accountancy profession through IFAC should cease, but fails to recognize that as well as funding the operations of the SSBs the global accountancy profession through IFAC funds well over half of the PIOB operations** and has guaranteed that funding until March 2019. IFAC agrees that there should be a multi-stakeholder funding model; and
- **are based on the assumptions that:**
  - **despite IFAC being an independent legal entity representing the accountancy profession the international regulatory community will state IFAC’s future role.** It is important to recognize that IFAC performs a range of public interest activities that may be impacted by the MG proposals, including supporting the development of public sector accounting standards;
  - **IFAC will be fully supportive of assisting the transition from the current arrangements** to a new more costly regulatory model, for which there is no supporting evidence that it would function effectively; and
  - **there will be a lengthy transition**, which IFAC believes can only be highly disruptive to standards development and have a significant adverse impact on staff morale and make the attraction and retention of talent more difficult.

### IFAC is not supportive of:

- **the creation of a single SSB for auditing and ethics.** Combining these two boards potentially dilutes the focus on each of the topic areas, and significantly reduces the current level of expertise and resources—that is, the time of SSB members and their technical advisers—devoted to each area of standard setting;
- **the bifurcation of ethics standards for professional accountants**, and having two separate sets of ethics standards—one for auditors and one for all other professional accountants;
- **funding via a contractual levy on the audit firms**, rather than the global accountancy profession at large as part of a broader multi-stakeholder funding base. This would heighten perception issues with respect to a lack of independence from the profession and the ability for the auditing profession to exert undue influence.

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Additionally, there appears to be no basis on which to collect a levy and could lead to a concentration in the audit market for audits of listed entities and public-interest entities due to some networks leaving the market;

- **a model that merges the roles of participation in, and public interest oversight of, the standard-setting process**, potentially reducing the legitimacy and credibility of standard setting, and confidence in the standards developed;
- **proposals that do not clarify the key role of the PIOB**. IFAC recognizes the important role of public interest oversight, which it believes must be clarified and reinforced. The MG must act to ensure that this role is properly fulfilled, and that the PIOB has the confidence of all stakeholders by acting in a transparent and consistent manner. Importantly, the separation between oversight and participation must be maintained and the PIOB should not engage in intentional direct technical input into standards;
- **a model that is insufficiently analyzed, has significant associated transition risks and adoption challenges, and where the costs and benefits are not adequately assessed**; and
- **a model that requires stakeholders to accept in good faith as yet unexplained key elements that will be designed at some point in the future**—for example, the role and responsibilities of the MG and PIOB, the Public Interest Framework that is the foundation of the MG proposals—to give effect to the fully envisioned proposals of the MG.

IFAC is concerned that after 30 months of working on this review, **the CP includes methodological shortcomings, as well as misleading assertions and misrepresentations**. In particular, the CP:

- **does not provide sufficient details on the consultations conducted to elicit the stated concerns** of constituents and stakeholders;
- **does not faithfully represent the features of the current model**, and incorrectly implies that the current model has fundamental flaws;
- **includes no risk and impact assessment**, especially in relation to the significant transition risks and challenges the proposed model presents with respect to adoption and implementation of standards;
- **is not structured to faithfully elicit a broad range of perspectives and views from a diverse stakeholder group** through a balanced approach;
- **has significantly incomplete information**, with many fundamental matters being deferred for later consultation; for example, the Public Interest Framework; and
- **gives respondents the option of not making available their responses to be shared publicly**.

*More detailed discussion of IFAC's concerns are included in Section B.*

### **Potential Reforms that Build on Past Successes**

IFAC is of the opinion that a series of potential reforms should be considered as an alternative to the proposals of the MG. These would substantially address the stated concerns raised in the CP. These potential reforms will continue to be refined by IFAC during the consultation period, based on the feedback it receives from its own extensive outreach to all key stakeholders who rely on high-quality international standards.

Based on the holistic review undertaken by the IFAC Board, potential reforms can be characterized as a **suite of seven significant proposals building on the strengths and successes of the standard-setting model**. Taken together, they would potentially address the stated, misconceived perception that the accountancy profession exerts undue influence in standard setting; retain and enhance the strong checks and balances currently in place to prevent undue influence by any one stakeholder group; and focus on enhancing the efficiency and effectiveness of standard-setting operations and processes. They reinforce the strong public interest focus that comes with a robust due process, exceptional levels of transparency, and an oversight structure that ensures that the public interest elements embedded in the system operate as expected.

At the same time, they promote **multi-stakeholder representation and funding throughout the process**, including on the SSBs, the PIOB, and Consultative Advisory Groups (CAGs). Additionally, IFAC believes that redesigned

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operating processes allow for efficiencies that address concerns about the relevance and timeliness of standards, which it recognizes are important matters that must be considered.

IFAC is of the view that potential reforms must be considered in the context of:

- recognizing the importance of independent public interest oversight and ensuring that the roles of oversight and direct participation—that is, direct input into standards development—are not mixed;
- ensuring that the scope of any changes to arrangements is proportionate to the problems being addressed;
- promoting the principle of a balanced multi-stakeholder model that will ensure all public interest elements and key stakeholder groups—including SMEs—are appropriately considered, and which encourage a more sustainable, long-term funding model;
- carefully considering the balance between principles-based standards and the exercise of professional judgment, and rules-based, prescriptive standards which promote a compliance culture;
- being clear on implementation and transitional risks and carefully considering the potential for unintended consequences; especially in relation to national adoption and implementation challenges and the disruption to auditing in a rapidly changing digital age; and
- recognizing that having reduced global representation in standard setting will potentially encourage greater national-based changes, amendments, and revisions to standards.

To enhance governance and oversight arrangements and related concerns, potential reforms include:

1. **Nominations arrangements that include other stakeholder groups.** For appointments to SSBs, IFAC supports: a Nominating Committee (NC) Chair independent of IFAC, the MG, and the PIOB; and a NC comprising an equal number of nominees from the accountancy profession and from other stakeholder groups, as nominated by the MG. IFAC strongly supports the notion of oversight and supports the widely held view that participation and oversight are incompatible. It believes that PIOB members or nominees should not participate in the NC, but should continue to observe the entirety of the nominations process, as they do now.
2. **That the role and operating processes of the PIOB be clarified and followed.** In particular, the PIOB should focus on its mandate of due process oversight and should not aim to provide technical input into standards development. Transparent and accountable public interest oversight is crucial to the success of international standard setting. In line with this principle of transparency, IFAC believes that appointments to the PIOB should involve selection criteria that reflect a true multi-stakeholder composition and clearly articulated skills requirements, including broad geographical diversity from developed and emerging economies and time limits on members' and Chair's appointments. The Public Interest Framework may assist in clarifying the PIOB's role. However, disappointingly, it is still being developed.

IFAC recognizes that addressing perceptions of a lack of independence and undue influence is crucial, both for the SSBs and for the governance structure, more generally. A multi-stakeholder focus is important. Potential reforms should have:

3. **A more explicit multi-stakeholder standard-setting board composition**, reformulating the structure from the currently constituted nine practitioners, six non-practitioners, and three public members, to better reflect the broad range of global stakeholders and to benefit from a range of stakeholder perspectives. IFAC supports a composition including: investors; those responsible for preparing financial statements; those charged with governance; academics; regulators; and the audit profession from all-sized audit firms from across the globe—and with strong gender diversity.
4. **Funding arrangements to which all stakeholder groups contribute, with transparent independent oversight.** Current arrangements, whereby the global accountancy profession through IFAC solely funds the SSBs and the majority of the activities of the PIOB should be reformed. The funding structure should be representative of the global public good and inclusive of all stakeholder groups. For many years it has been an objective to diversify funding of the PIOB beyond the global accountancy profession—for example, from regulatory authorities—however, these efforts have not been successful. While a robust system to

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appropriately fund all elements of the standard-setting process is currently in place, IFAC believes that current funding arrangements can be made clearer and more transparent to all stakeholders. It believes arrangements can also be strengthened through enhanced multi-stakeholder oversight of the manner in which funding is deployed to achieve strategies and work plans (SWPs)—noting that currently the PIOB oversees and approves SSBs' SWPs, and the adequacy of funding.

To enhance the timeliness and relevance of standard setting, potential reforms should consider the following:

5. **Reconsider the optimum size of the standard setting boards.** IFAC notes that the SSBs' current size of 18, which has been in place for many years to promote broad geographical and skills diversity, may not be optimal and could potentially be smaller. However, SSBs should be of sufficient size so they can reflect appropriate geographic and skills diversity, and international legitimacy, but not be so large as to generate unproductive discussion. This diversity must include representatives of the small and medium practices community, whose inclusion is not readily envisaged under the MG proposals.
6. **Retain separate standard-setting boards for auditing and assurance, and ethics for the entire accountancy profession.** The public interest arguments for retaining two boards, and the potential risks of creating one single board, are described earlier.
7. **Examine the scope to redesign processes and operations of the standard-setting boards for greater efficiency and effectiveness.** Potential reforms might include the following:
  - a. **Continued exploration of closer liaison between the IAASB and IESBA on key projects.** IFAC welcomes the boards' efforts to enhance this liaison, including the recently initiated practice of holding joint sessions of the two boards.
  - b. **Review the appropriateness of having different due process arrangements for different work streams.** The SSBs and the PIOB should discuss this, using lessons learned from past projects with a focus on enhancing speed by creating additional flexibility; for example, by having different due process arrangements for different streams of work.
  - c. **Review processes for identifying and responding to regulators concerns,** in particular with respect to the enforceability of standards.
  - d. **Revise processes to rebalance the detailed work undertaken by the standard-setting boards and technical staff.** For example, consideration should be given to how the amount of detailed page-by-page drafting performed by the SSBs in plenary might be limited. To the extent possible, the SSBs should undertake detailed drafting only once key issues have been discussed and agreed and the near final pronouncement is due to be discussed and approved.
  - e. **Continuously leverage technology to gain efficiencies.** IFAC encourages the SSBs to continue work already underway to examine ways for SSBs to enhance efficiencies through the use of technology, for example, in the areas of stakeholder comment analysis and document review management.
  - f. **Align staff numbers and skills** to evolving standard-setting arrangements. The board Chairs, technical support staff, and oversight bodies (as appropriate) should initiate a dialogue to ensure the sufficiency of staff resources. They will need to consider how best to acquire and retain the technical expertise needed to achieve their SWPs.

***Further details of these proposals for an alternative model are outlined in Section C under each of the three categories noted above.***

IFAC is committed to playing its role in solutions that serve the public interest throughout the standard-setting process