



6 February 2018

By email to: MG2017consultation@iosco.org

Monitoring Group Consultation: Strengthening the Governance and Oversight of the Audit-Related Standard Setting Boards in the Public Interest

Dear Sirs

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. The Council of the HKICPA has a long established policy of converging local professional standards with international standards. Hong Kong Standards on Auditing and the HKICPA Code of Ethics have been fully converged since December 2005 with International Standards on Auditing and the Code of Ethics for Professional Accountants, issued by the International Auditing and Assurance Standards Board (IAASB) and the International Ethical Standards Board for Accountants (IESBA) respectively. Therefore the HKICPA has a very real interest in the international standard setting process and has close working relationships with IAASB and IESBA. We believe that the current system produces high quality standards and therefore have read the Monitoring Group (MG) proposals for change with interest.

The Monitoring Group Consultation Paper (MGCP or CP) acknowledges that standards produced under the current model command international respect and have been widely adopted. However the MGCP then sets out three key concerns that have been identified by stakeholders:

1. The **adverse effect on stakeholder confidence in the standards as a result of a perception of undue influence by the profession** on two grounds:
 - (a) IFAC, representing the global accountancy profession, manages the nomination process of the standard-setting boards, and directly funds, accommodates, and provides support and staffing for the standard-setting boards – IFAC itself is funded by member organizations and the global accountancy profession; and
 - (b) Audit firms and professional accountancy bodies provide a majority of board members and their technical advisors.
2. Partly because of such undue influence, there is a risk that **standards are not developed fully in the public interest**.
3. The **relevance and timeliness of standards**. The pace of change in audit and the business environment is accelerating. It is essential to ensure that the standards are relevant and up



to date in order to underpin audit quality and user confidence. Where the market or the regulatory community identifies a need for a new or revised standard, the Board should be able to respond on a timely basis (e.g. responding in a timely way to the greater use of data and analytics in audit).

The reform options in this document are said to have been developed to address these challenges. The main focus is to address the issues of independence and public interest. We agree that standards being relevant, timely and in the public interest are absolutely fundamental requirements. However, the CP fails to specify what flaws there actually may be in the current system, apart from a general reference to perception, so it is difficult for us to decide whether such wholesale changes as are proposed are necessary. Where there are weaknesses or flaws in the system they of course should be addressed but whether abandoning the current system completely is the most appropriate approach is questionable. We would be completely open to considering enhancements to the system that would address evidential weaknesses.

Before addressing the specific questions that are posed in the CP (**Annex 1**) we would like to raise a number of matters which we believe to be fundamental to the whole concept and rationale of the consultation exercise:

1. The CP begins by stating that there is a perception of lack of independence from the audit profession and that the profession is exercising undue influence in the standard setting process. However, the rest of the CP seems to be constructed on the assumption that changes are necessary because there is an actual, rather than perceived, problem of undue influence. Take up of the standards has been extremely wide, ISAs being adopted in more than 100 jurisdictions, and the CP does not provide evidence that the standards not being adopted because of perceived or real issues of undue influence of the profession.
2. Stakeholder consultation before issuing the CP seems to have been quite narrowly based, focusing on the standard setting community and current participants in the standard setting process and oversight thereof. From our sources and comments made at the roundtable meeting in Singapore we believe that engagement with stakeholders in Asia-Pacific was minimal, a matter of some concern given the importance of the region in the global profession and business world and that many jurisdictions in the region are strong supporters of international standards and significant participants in international standard setting. We appreciate that this CP is framed as a "first stage" but given that the proposals in the CP are far-reaching and may have significant consequences for many stakeholders we feel that a wider consultation base could have been engaged before publishing the CP.
3. The initial views paper published by the International Federation of Accountants (IFAC) soon after the issue of the CP suggests that IFAC encouraged the MG to consult with it and other key stakeholders in the development of the CP but that this did not happen. Similarly, a letter issued jointly by the Chairs of the IAASB and IESBA soon after the issue of the CP suggests, that their views may not have been sought or fully considered in the development of the proposals outlined in the CP. We believe that the MG should approach any reform



initiative in an open and collaborative way by engaging with all key stakeholders including IFAC. To achieve sufficiently wide acceptance of any reform proposals there needs to be full engagement and agreement of all key stakeholders such that the proposals do not reflect the views of just one party.

4. We understand the potential issues and supporting principles for standard setting in the public interest that are set out in the CP but there is no consideration of the extent to which the current system meets the principles or could be finessed to address any real issues. The CP seems to start with the presumption that the current system simply has to be discarded and replaced which we find a less than constructive approach.
5. There is only very limited information about the current standard setting system, including process and checks and balance, in the CP. This does not give a full picture to potential consultees and may contribute to a somewhat biased understanding of how the current system works, its strengths and where weaknesses might be. IFAC has attempted to address this by issuing its own paper providing more information on the current system. In our view such information should properly have been included in a fully informative CP.
6. The role of the MG in the current system is not given prominence in the CP. The MG exercises authority over the oversight systems and activities of the Public Interest Oversight Board (PIOB), has representatives of the Consultative Advisory Group (CAG) of both Boards and periodically reviews the fitness of the existing system. As the MG has been an intimate part of a very successful model for the entire time of its existence and has been recognized in its important role in the development of high-quality international standards it seems somewhat disingenuous to now be arguing that the current system is not suitable and needs to be completely replaced.
7. Primarily as a result of the above points, the actual extent and any examples of failings in the quality of published standards that are of concern to stakeholders are not clearly articulated. Nor is there any evidence that the standards have failed the public interest, the issue apparently being around perception. If the key issue is indeed one of perception then we would suggest that this could be addressed by education and clarification rather than a wholesale replacement of the standard setting system. We would further venture that the MG, in its position as guardian of the standard setting system, is ideally placed to provide the necessary education and clarification to amend stakeholder perceptions.
8. The proposal to combine the activities of IAASB and IESBA into a single twelve member Board is something we cannot support. We believe that cutting the number of Board members actively involved in the standard setting process to potentially only one third of the current complement would have a wholly negative effect on the participation of experienced and appropriately skilled individuals in the process. Proposals in the CP about increasing numbers and quality of technical staff supporting the Boards are not sufficiently well formed to give confidence that the reduction in numbers of Board members would be adequately

compensated for. The CP envisages some staff being provided by secondment from stakeholders. Given that the most likely source of appropriately skilled secondees would be large audit firms we suggest that this would continue the issue of perceived influence of the profession over standard setting.

9. A second issue arising from the proposal to merge IAASB and IESBA is that so drastically reducing the number of Board positions for willing participants would make it very difficult to get fair representation of all stakeholder groups and jurisdictions. In our view the proposals would result in a less encompassing "multi-stakeholder model" than exists under the current system. We are concerned that a consequence of this may be that, contrary to assertions in the CP that the proposed changes would increase international acceptance of the standards, some jurisdictions might abandon adherence to international standards and return to national standards. This is not an outcome that would be in the interests of consistent quality and standards in capital markets around the world.
10. The CP has been issued before an impact assessment, including quantification of the costs of the proposed changes, has been carried out. The CP states that this will be done after consultation and before final proposals are put out, as will detailed consideration of resource implications, transitional arrangements and funding models and sources for the new standard setting system. Given our reservations that this CP is much more than just a first stage of considering potential changes to the standard setting system we are concerned that these critical exercises have not been carried out. To bring in such significant changes without considering potential implications could seriously damage the credibility of the international standard setting process. We believe that the analysis provided in the joint IAASB and IESBA position paper is very useful in this respect and is the approach we would have hoped to see in the CP.
11. We believe that as a matter of principle operational standard setting functions and oversight activities and responsibilities should be clearly separated. We are concerned that the proposals seem to suggest a less clearly defined separation of functions than exists in the current model as there are proposals for the PIOB on occasion to take a direct role in the process of standard setting rather than oversight.
12. The CP advises that the MG and the PIOB will develop a framework that will provide a mechanism for assessing how the public interest is captured throughout the standard setting process. In this context the CP contains the comment that the framework should take into account factors including "balancing the varying requirements of stakeholder groups relevant to each of the standards under consideration with a purpose of ensuring that the views of those with the greatest concern about and commitment to the public interest in a particular area are properly considered". The assertion seems to be that certain bodies, impliedly the regulators, have a better understanding of and are more likely to work in the public interest than others. We reject that any one party has a unique ability to determine and claim to be the only party that effectively works in the public interest. The accounting



profession has a long history of clear commitment to acting in the public interest and we reject the suggestion that it is not able to recognize and address public interest concerns.

13. We recognize the concern expressed in the CP about timeliness of development and issue of standards and welcome constructive discussion on how this can be improved. However, we feel that the precedence of quality over speed of production of standards must be maintained and the CP should be very clear on this point. Based on the proposals in the CP we are not convinced that the alternative structures and processes, which are not clearly defined, will increase timeliness with no impact on quality.

In conclusion, the HKICPA is a very committed participant in the international standard setting process and user of international standards. The HKICPA is willing to contribute to constructive discussions on how the process can be further enhanced. We are committed to a multi-stakeholder model of standard setting and believe that a fully engaged dialogue between all relevant stakeholders is the correct way to move forward and ensure that high quality standards are available for all.

If you have any questions regarding the matters raised in our comment letter, please contact me at chris@hkiipa.org.hk or by phone at +852 2287 7372.

Yours faithfully,

Chris Joy
Executive Director



QUESTIONS FOR RESPONDENTS

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?
We recognize that the three matters identified as "concerns" are central to an effective standard setting model. However, we do not recognize these matters as weaknesses in the current system and the consultation paper (CP) does not provide evidence of fundamental flaws. The CP begins by stating that there is a perception of lack of independence from the audit profession and that the profession is exercising undue influence in the standard setting process. However, the rest of the CP seems to be constructed on the assumption that changes are necessary because there is an actual, rather than perceived, problem of undue influence.
2. Do you agree with the overarching and supporting principles as articulated? Are there additional principles which the Monitoring Group should consider and why?
We agree with the overarching principles but do not believe that these are lacking in the current system.
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?
We have no suggestions for additional factors to include in the framework but will be interested to see how the PIOB develops the framework and articulates public interest.
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.
We support the retention of separate boards for auditing and assurance and ethics. We believe that cutting the number of Board members actively involved in the standard setting process to one third of the current complement would have a wholly negative effect on the participation of experienced and appropriately skilled individuals and the benefits of geographic as well as sector diversity in the process.
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?
Yes.

Annex 1

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

All professional accountants should be expected to conduct their business to the highest ethical standards. We do not support the separation of setting ethical standards for practising and non-practising professional accountants, or PIE and non-PIE auditors, into different bodies as this may affect the consistency of ethical standards between different sectors of the profession.

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.

In our view the CP is premature. Any process of reform should not be driven by the agenda of a single stakeholder but should be transparent and collaborative, engaging all stakeholders in ensuring a sustainable model for setting effective standards.

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?

We agree that standards setting boards should consider strategy, which they currently do with input from the PIOB and the CAG, but are concerned that the proposals in the CP would result in board members having little to do with development of standards. As explained in our covering letter the current composition of the boards ensures that appropriate skills and experience are brought to the process and the proposed model does not give confidence that a reduction in skills and experience at board level would be adequately compensated for by other elements of the model. We also believe that the proposals made to increase the numbers of professional staff, although not explained in detail, would have to look to the major audit firms as the main source of appropriately skilled individuals. This would not have a positive effect on the matter of perception of the professions influence in standard setting.

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

We understand that this is already the case although every effort is made to achieve consensus. We would be concerned if it became normal for standards to be issued which were not agreed by almost 50% of stakeholders represented at the board level. It would not be practical for issue of standards to be approved by 100% of board members but we suggest that the existing "super majority" of two thirds would continue to be appropriate.

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?

We would not support a single board composed of twelve members. Given that the proposal leaves it open for the size of the board to be more than twelve any further comment would depend on the actual size.

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

The same skills and attributes that are required of current standard setting board members – commitment to the public interest and high quality standards, an understanding and experience of the value of audit and the audit process from a variety of stakeholder viewpoints and the ability to bring sector and jurisdictional issues into the standard setting process.

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?

The CAG bring an important independent stakeholder perspective to the strategy and agenda of the standard setting boards and in our view should be retained.

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

This question seems to imply that task forces have failed to work in the public interest. We do not accept this presumption as we believe that the whole of the current standard setting process takes public interest into account. Until we see the public interest framework being developed by the PIOB we cannot comment further.

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

Yes.

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

Annex 1

responsibilities that should be assigned to the PIOB to ensure that standards are set in the public interest?

We believe that the whole governance process including the number of layers and the roles of the PIOB and the MG should be part of the review under the principle that those involved in process oversight should not participate in the activities subject to oversight.

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

The PIOB should be a multi-stakeholder oversight body and as such there is no reason to preclude IFAC.

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?

As the body exercising oversight of the standard setting process PIOB members should represent all key stakeholders.

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?

As mentioned above we believe that the MG should work collaboratively with other stakeholders on the governance structure. Until that happens it would be premature to respond to this question.

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?

We do not believe there is a need for PIOB to oversee the work IAESB and do not support the proposal to split the responsibility for setting ethical standards for practising and non-practising professional accountants.

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?

This consultation is an opportunity to review the oversight mechanism for standard setting to ensure clarity and no duplication of roles and activities.

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?

Additional technical staff would be beneficial but this should not be at the expense of skills and experience within the boards.

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

Yes.

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

No comment.

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)?

This could be achieved but we also believe that the same could be achieved in the current model.

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 opt for in the paper, and if so what are they?

We believe that the perception of funding by the profession would not be significantly addressed by the use of a contractual levy and suggest that alternative options for multi-stakeholder funding are explored.

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



Annex 1

We believe that the MG should approach any reform initiative in an open and collaborative way by engaging with all key stakeholders. To achieve sufficiently wide acceptance of any reform proposals there needs to be full engagement and agreement of all key stakeholders such that the proposals do not reflect the views of just one party.

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

See our response to Q26.