The Monitoring Group
Via electronic mail: MG2017consultation@iosco.org

8 February 2018

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

Dear Monitoring Group,

Thank you for the opportunity to comment on your consultation. Below I set out key matters for your consideration from my public interest perspective as Chairman of the IAASB.

My comments have benefited by informal input from IAASB members and from the discussions at your three roundtables. The Appendix to this letter provides my response to select consultation questions based on my experiences over the last decade as Chairman.

Overarching Considerations

Your consultation discusses important issues. Such issues indeed need to be settled in order to improve satisfaction by all stakeholders with the international standard-setting arrangements.

The exam question, I believe, is: What is essential 'to fix' – where are the fundamental tensions and actual deficiencies and, from there, what changes would make a real difference?

The goal to be achieved: An arrangement that optimizes the likelihood of all stakeholders' long-term and sustained acceptance and satisfaction – thereby ensuring the IAASB and IESBA and their international standards escape similar criticism or negative perceptions that presumably exist today.

The principles to follow: Remain reform-minded; retain strengths of the current model while improving on essential areas where legitimate concerns exist. Bring forward change that directly addresses concerns, is capable of being implemented quickly and with clarity and confidence, and with minimal disruption. Rigorously challenge the point at which impact and cost exceed benefit. Keep it simple.

Key Focal Areas

Below I identify the two principal dimensions – one at the governance and strategic level, the other at the operating level – that offer the potential to alleviate so-called perceptions of undue influence by any stakeholder group and improve the axes of relevance, timeliness and public interest. These are:

1. Agreeing Standard Setting Strategy & Priorities – that is, the mechanism around WHAT ISSUES the IAASB is to focus on and AT WHAT PACE, and which ones they will not deal with at any point in time.

2. Recalibrating the Task Force Model – that is, ensuring the veracity of the INPUT and on WHOSE recommendations the IAASB's deliberations and decision-making are based.

Unless these are addressed, the existing model -- or a new model -- will continue to suffer dissatisfaction by stakeholders, including perception concerns. The more granular matters set out in the MG consultation do not address the fundamental tensions that exist around (1), and offer a sub-par solution against the strength of today's modus operandi for (2).

I elaborate below. For analysis purposes, I assume satisfactory arrangements can be arrived at between the MG and IFAC along key lines[1] where already there seems broad directional agreement.

Agreeing Standard Setting Strategy & Priorities

While governance and structures are an important consideration, the accountability of the strategic-planning process is at least as critical to organizational success. Indeed, priorities-setting is the most pivotal public interest stage of the standard setting process. It involves the most difficult judgement calls of all. It is the area fraught with the most tension. It is the decision-making point which 'one cannot get wrong' from a public interest point of view. And it has far-reaching consequences in terms of meeting expectations, relevance, capacity and timely delivery.

The MG proposals assume that variations on today's checks and balances will achieve a better result than today. That is, there seems to be an expectation that a re-composition of the Board, the PIOB, and staff will arrive at a more acceptable set of priorities to the greater satisfaction of regulators, investors, and other national stakeholders.

That is doubtful. Fundamental tensions (dissatisfaction) may persist in the light of disharmonized regulatory perspectives, differing (sometimes conflicting) opinions from the independent PIOB, and varied national and regional stakeholder needs. This will again lead to negative perceptions and unjust criticisms of the role of self-interest and undue influence of any professional accountant serving on the Board(s), or of other architecture elements, including the PIOB.

Here, a more fundamental change may be warranted toward a more meaningful outcome.

An arrangement, therefore, may involve the continued development of proposed strategy and priorities by the Standard Setting Board(s), but enhanced by:

i)   The designation of final authorization (or amendment) of the priorities to a **senior Trustee body**, including as appropriate, authorization of scoping of priority projects.

     It is essential that such a senior Trustee body be **multi-stakeholder** to build confidence across all stakeholder groups.

ii) Such a Trustee body to be informed based on proposals of the SSB but further examined, as deemed necessary, through testimony from specialized interests such as the MG, the GPPC and those representing SME needs, the PIOB, the SSB itself or other standard setters, or hearings involving any other stakeholder constituency, including investors, preparers, and the public sector.

iii) Such final authorization (or amendment) to be based on a significant majority of the appointed membership of the Trustee body.

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[1] These include: (i) An improved Nominating Committee composition and process; (ii) Enhanced SSB multi-stakeholder composition; (iii) Additional investment such as stipends for voluntary (part-time) members which result in potentially more diverse and deeper pools of candidates for the Boards; and (iv) Additional investment to expand the permanent technical staff. Each of these could already offer a positive impact on perceptions of undue influence by specific constituencies and on the overall productivity of the Boards.

The above holds several benefits. Firstly: resolve at the highest level on the top standard setting priorities in the public interest by key multi-stakeholder representatives, without concern or perception of undue influence by anyone stakeholder group. It also establishes a platform for dialogue on the greatest future risks facing the system and markets.

Secondly: a mechanism for clarity and acceptance of the benefits, risks and consequences of prioritization decision, including consensus building on decisions that a SSB will not pursue any particular stream, or will do so at a slower pace.

Further: if properly done, concomitant improvement in the perceived relevance of the standards as well as timeliness. This is because efforts will (and will be seen to be) deployed in a concerted manner to areas of most importance.

Finally: it allows the Board to more fully focus on operational objectives to deliver on the agreed strategy and priorities (and against which the Board's performance can be measured and monitored), and the PIOB to more fully focus on oversight of production of the standards.

Recalibrating the Task Force Model

Concern has been expressed regarding the degree of influence practitioner-experts are able to exert at the standards-drafting level. This so-called influence is seen to stem from their comparatively deeper capacity to engage, contribute content, develop rationale, etc. On the other hand, the importance of such input to developing quality standards that can be globally accepted and implemented is also acknowledged.

The fact is that IAASB task forces largely mirror the balanced composition of the Board itself. The IAASB composition comprises a 50-50 balance between practitioners and public members/non-practitioners, including the independent Chair. Further, task forces are not decision-makers; rather, all significant task force proposals are subject to advice from the independent Consultative Advisory Group, and all task force matters are brought to the attention of the Board itself for deliberation and decision in public meetings, where the balanced composition of the SSB is the main and desired safeguard for quality of the board's output. Still, there are perceptions otherwise.

The MG proposal to move all principal technical and drafting deliberations to the staff level, and to enhance that staff capacity with greater involvement of firm personnel, however simply shifts the problem. Indeed, it potentially worsens transparency through having relevant technical debates happening wholly outside of Board plenary discussions; instead, at the staff level where expert or other stakeholder influences may occur in a more unchecked manner, and where the current broad-based input of the task force model may not be replicated.

The alternative, therefore, is to recalibrate today's task force model[2] focused on a two-fold reform to: increase confidence in the balance and caliber of individuals involved; and enhance transparency.

A potential recalibration might feature:

   i)   Open-calls for nominations for participation in task forces, including explicit terms of references for task forces and background/ skills matrices for desired participants.

   ii) PIOB review and approval of task force compositions.

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[2] Recognizing however that task forces have been instrumental 'working units' behind the overall capacity, quality, and speed of work of the IAASB, and that they must remain operationally flexible and efficient.

iii) PIOB observation, as deemed appropriate, of task force deliberations.

iv) Additional transparency surrounding task forces, for example more transparency regarding task force operating procedures.

This is not in lieu of investment to expand the permanent Technical Staff. That in and of itself can have positive effects on the efficient functioning of task forces and the Board, and on related burdens on participants. However, the above builds on today's arrangement that has proven to be successful.

Piloting and Testing Other Changes

The dimensions discussed above have the potential to substantively address the MG improvement goals when taken in combination with a revised multi-stakeholder Board composition, yet not at the expense or potential damage that may arise from a wholesale restructuring. Further, my suggestions align with those that recommend clarity around the role of future governance of the system, which I agree is essential for the MG to articulate and which should itself also be multi-stakeholder in nature.

Improving the dimensions described above will require effort, attention and investment, and this should not be underestimated. I would therefore encourage the MG to reflect on whether further incremental change is necessary and worthwhile in the light of further disruptions and uncertainty. Other possible improvements can be effectively explored and implemented under a separate piloting and testing program, monitored by an appropriate group, including MG representatives, as the IESBA Chair and myself have previously recommended to you.

Closing

I am troubled by how unsettling the approach offered by the MG is to the many who have been committed and instrumental to bringing about worldwide use of the ISAs[3] and the IESBA Code of Ethics. This disconcertment is serious and should not be downplayed.

The cause is obvious: the prospect of a wholesale restructure of the remits and mechanics of the SSBs, with new complexities and uncertainties; many variables being changed and no idea if they will work; no clear governance arrangements; and, above all, major risks. Compounding these concerns, is the fact that the consultation is not based on the realities of the SSBs as many know them. The decision to omit a serious analysis of evidence, current facts and processes, root causes, options and risks is regrettable, leaving the value of the proposals dubious and largely supported only by conjecture.

I encourage the MG to take the time needed to fully and critically examine stakeholder feedback provided through the various roundtables and the responses to this consultation when collaborating on the development of the next consultation.

Sincerely,

Prof. Arnold Schilder
IAASB Chairman

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3   As well as the ISAEs, ISREs, ISQC 1, and the International Related Services Standards.

Responses to Select Consultation Questions

<u>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?</u>

On the first part of the Question – No.

The independence of the standard setting process, the importance of addressing the public interest, and the timeliness of standard setting are important determinants of an effective standard setting structure and process. These are not, however, deficiencies in the current standard-setting model, as they are the basis on which IAASB operates.

To note:

- The IAASB has been fully independent in decision-making on scope, content and timing of its standards. The Board and its Technical Staff have not been subject to any pressure, influence or interference as a result of IFAC providing operational & financial support.

- The IAASB has always given weight to the public interest throughout the standard setting process. This has included ensuring plenary contributions from all members (currently comprised of equal numbers of public members/non-practitioners : practitioners) and considering the public interest input from our international Consultative Advisory Group (CAG). The remarks of PIOB Observers in this regard, based on observation at each IAASB and CAG meeting, are on record, as are the PIOB due process approvals of the IAASB's Standards.

- The level of global adoption of our auditing standards in both the private and public sectors, including adoption through legislation and by public authorities, is testimony to the confidence in the quality of the standards as a result.

Recognising that there will always be scope for improvement, the IAASB is constantly challenging and re-thinking its approach towards continuous improvement.

There is nonetheless concern about perceptions. Please see the cover letter which identifies two principal dimensions – one at the governance and strategic level, the other at the operating level – that offer the potential to alleviate so-called perceptions of undue influence by any stakeholder group and along the axes of relevance, timeliness and public interest.

On the second part of the Question – No.

<u>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?</u>

On the first part of the Question – Yes.

The principles articulated in the consultation paper are essential to an effective standard setting process – and they are the basis on which IAASB currently operates.

On the second part of the Question – No.

<u>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.</u>

No.

The MG has not put forward compelling reasons to justify the prospect of disrupting the present arrangements in the manner proposed.

The MG's attention is drawn to the number and complexity of audit and ethics projects on the IAASB and IESBA current and forward work plans. Any future arrangements should take account of the skills, expertise and overall capacity of the Boards (or Board) necessary to accomplish the work required.

<u>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.</u>

Yes.

Please see the matters raised in the cover letter.

In particular, it is noted that while governance and structures are an important consideration, the accountability of the strategic-planning process is at least as critical to organizational success.

In this regard, the MG should consider the source and solutions to the fundamental tensions that exist around strategy and priorities setting that may persist in the light of disharmonized regulatory perspectives, differing (sometimes conflicting) opinions from the independent PIOB, and varied national and regional stakeholder needs.

The concept, therefore, of a **multi-stakeholder senior Trustee body**, with responsibilities extending to final authorization or amendment of <u>standard-setting priorities that have the greatest public interest relevance, and those that do not,</u> is offered for consideration by the MG.

<u>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?</u>

On the first part of the Question – Yes and no.

Please see the issues raised in the cover letter, which are the more essential matters to be considered.

Having said that, it is appropriate that a Board should adopt a strategic approach both to the discharge of its remit and to the development of standards. However, that should not be at the expense of careful consideration of the text of standards because the effectiveness of a standard, its ability to be understood and implemented, and its enforceability will be dependent upon the clarity of that text. This is actually well expressed by the MG itself on page 14 of its consultation, where it includes in the anticipated Board's responsibilities: "Scrutinising and challenging draft standards and resolving the way forward on contentious matters, (and) Detailed review, adoption and promotion of high-quality standards, noting that the Board should not draft text itself in Board meetings".

Such balance between strategy and detailed review largely exists in how the IAASB operates today. Nonetheless, the IAASB recognizes the need for continuous improvement. To this end,

the IAASB is already looking at ways to enhance the strategic focus of deliberations, including improvement of the structure of staff papers and focusing Board discussions on the most significant issues.

In regard to the MG's detailed proposals for arrangements surrounding 'a more strategic focused Board' (and only a limited review of text – but how limited actually?), the following questions arise:

- To what extent will the proposal impact clarity and technical quality of the standards and resultant bases for conclusions? How will translation considerations be considered, and how does this impact local adoption processes?

- How are members' responsibilities to comprehend and evaluate significant technical matters affected, including those pursuant to jurisdictional differences? And how are members to discharge their responsibilities concerning disposition of stakeholder input?

- What is to be the revised CAG-Board relationship?

Accordingly, this is an area where piloting and testing would be an appropriate approach.

On the second part of the Question – Yes, if remunerating all Board members would enhance the prospects of recruiting high quality individuals from more diverse and deeper pools of candidates drawn from all stakeholder groups. However, this assumption would need evidence.

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

Yes, but this is already the case.

It should be noted that today's arrangement of a two-third majority (12 out of 18) has not been problematic concerning the speed of approval. It is doubtful that an absolute majority basis (10 out of 18) would accelerate the process in any meaningful way.

It is also noted that near-consensus by all Board members is very useful in the context of the quality of the standards, including acceptability and implementability in the wide range of jurisdictions in which the standards are to be applied.

Please see the issues raised in the cover letter, which are the more essential matters to be considered.

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?

As noted in response to Question 4, the MG has not put forward compelling reasons to justify the prospect of disrupting the present arrangements in the manner proposed, including merging the IAASB and IESBA.

The size of the Boards (or Board) should be sufficient to ensure the global representation and diversity, including SME/SMP and public sector, needed to fulfil their mandate of producing high quality international standards.

The MG's attention is drawn to the current IAASB composition comprising a 50-50 balance between practitioners and public members/non-practitioners, including the independent

Chair, and the diversity in skills, expertise, background and geographies, all of which are enabled by a size of 18, carefully monitored by the Nominating Committee and overseen by the PIOB.

The MG should also reflect on the viability of a significant reduced sized single Board in light of the number and complexity of audit and ethics projects on the IAASB and IESBA current and forward work plans. Notwithstanding a potential expansion of technical staff, it would seem unlikely that a single combined Board would have the same capacity (including plenary time) as that of two separate Boards.

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.

It should be noted that the IAASB (and IESBA) CAG is comprised almost entirely of a broad variety of non-auditors from a variety of stakeholders and from around the world. This is in contrast to the assertion in the MG consultation that the CAG should be continued to be used to provide 'practitioner and other stakeholder input'.

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

With respect to how task forces operate today, it should be noted that IAASB members and technical advisors annually sign a statement declaring they will act in the public interest; this extends to their efforts in plenary sessions as well as when participating in task forces. The notion that task forces should therefore adhere to a public interest framework is not incongruent with today's practices. However, it is unknown what specific content will shape the proposed public interest framework and therefore not possible to answer the specific question definitively.

It will be important that the public interest framework be developed in a collaborative and inclusive manner that ensures multi-stakeholder participation, and for the framework to be exposed for comment, to ensure common understanding and acceptance by all relevant stakeholders.

Please also see the issues raised in the cover letter. Specifically, it is suggested that an opportunity to alleviate so-called perception concerns of undue influence by the profession through the task force mechanism could be pursued by way of recalibrating today's task force model to increase confidence in the balance and calibre of individuals involved in task forces, and to increase transparency of task force activities.

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

No.

The importance of significant allocation of resource, diligent process, depth and breadth of reach, robust and careful administration, synthesis of inputs and views (including member and Chair performance reviews), and the weighing of numerous factors – all of which are essential to an effective nominations process – simply cannot be understated. The Nominating Committee, as overseen by the PIOB, has consistently demonstrated its ability to operate the nominations process effectively.

The PIOB as currently arranged simply does not have the capability to replicate or advance upon today's system, and it is doubtful it would be able to do so in the foreseeable future to the same efficacy.

The PIOB currently oversees all aspects of the nominations process. Perceptions of legitimacy and independence of the nomination process could be improved by increased transparency of the PIOB assessments of adherence to due process.

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?

On the first part of the Question – No.

With the exception of the proposed new involvement by the PIOB in the nominations process and in collection of funds and budget approval, the functions set out in the MG consultation appear to largely already exist within today's PIOB practices.

With regard to the proposed new involvement by the PIOB in nominations, please see the response to Question 14. In a similar vein, with regard to funding and budget approval, the importance of significant allocation of resource, diligent process, and robust and careful administration cannot be understated. The PIOB as currently arranged simply does not have the capability to replicate or advance upon today's system, and it is doubtful it would be able to do so in the foreseeable future.

On the second part of the Question – This is actually the case. The IAASB and IESBA need to submit all Board-approved standards to the PIOB for its own approval. The PIOB can also challenge the technical judgments made by the Board at any point because of the active speaking rights of its observers to the Board's meetings, and indeed does so regularly, as is evidenced in the PIOB's annual reports.

However, there are different views whether an oversight body should intervene in the Board's technical debate. Timely and informed interventions can be constructive and serve as a valuable input into the process. However, it is problematic if the interventions come too late or are not well informed. The MG's attention is drawn to the remit and operation of the IFRS Trustees with respect to oversight of standards development and their practice to not intervene in the technical judgements of the standard-setter.

On the final part of the Question – It is recommended that the PIOB move to adopt a fully transparent operating model.

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?

Please see the matters raised in the cover letter. In particular, the perspective that the accountability of the strategic-planning process be enhanced by the concept of a **multi-stakeholder senior Trustee body**, with responsibilities extending to decisions concerning the prioritization of those standard setting priorities that have the greatest public interest relevance, and those that do not.

The MG is strongly encouraged to consider the unintended risks arising from its proposals. Risks include:

i) Slower standard setting and lower quality of standards

ii) Lower stakeholder confidence

iii) Misaligned structure and mandate, thereby reduced national acceptance of standards

iv) Impractical or counter-productive change, thereby standard setting disruption

v) Decline in adoption levels, less effective implementation, and lower compliance.

These are elaborated in our Letter to IAASB & IESBA Stakeholders dated 17 November 2017.

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?

On the first part of the Question – Yes and no.

Additional investment in permanent technical staff is welcomed.

However, the MG proposals imply an arrangement whereby the more 'strategic focused' Board will place greater reliance on staff for technical decisions. The implications of this need careful consideration when contemplating arrangements for an expanded professional technical staff, in particular: the nature and parameters of the roles, responsibilities and duties of the so-called new Executive staff and the Board itself, respectively.

There is the risk that the sphere and scope of influence of staff becomes unbalanced relative to the Board itself. This may be particularly problematic given the MG proposal for the use of secondments drawn from audit firm resources—alongside a smaller, less technical Board - which has the potential to heighten the perception of undue influence by the accountancy profession in matters of standards drafting.

Further, the experience in cases has been that senior-level or highly-specialized experience does not translate readily to the skills needed for technical drafting of international standards or facilitating adherence to the protocols of Board debate and due process. The MG proposals do not appear to recognize this, and thereby overlook the concomitant risk to standard-setting quality and speed.

Accordingly, this is an area where piloting and testing would be appropriate before making final conclusions.

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

No.

Please see the issues raised in the cover letter, which are the more essential matters to be considered.

It should be noted that today's arrangements involve the recruitment, evaluation, retention and remuneration of Technical Staff under the responsibility of the Managing Director, Professional Standards, who functionally reports to the Chairs of the IAASB and IESBA. If perception issues exist relative to the relationship with IFAC, they would likely be more efficiently resolved through other means such as additional education or communication to promote awareness and understanding, or further transparency.

It is also important to note that under today's arrangements a wide range of corporate services are provided effectively by IFAC. In connection with Human Capital, this includes legal,

immigration, training and performance management and development systems. Support services also include IT, Communications, Intellectual Property, Facilities Management, etc.

It would be unfortunate if Board attention was redirected away from standard setting to attend to such matters. A solution whereby a transparent Service Level Agreement between IFAC and the SSBs is in place may be a more effective and efficient arrangement.

<u>Q 23 Are there other areas in which the board could make process improvements – if so what are they?</u>

It should be noted that various efforts are already underway by IAASB and IESBA towards the MG's ends, including initiatives (among others):

- To enhance the strategic and technical coordination between IAASB and IESBA, including joint Board and CAG sessions, to identify and resolve issues that affect both their respective standards.

- To enhance the strategic focus of deliberations, including improvement of the structure of Staff papers and focusing Board discussions on the most significant issues.

- To encourage staff to explore how to modernize processes and enhance efficiency, including through improved technology use.

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

To foster effective, long-term, and sustainable results, there should be a transition plan during which the required changes are introduced, tested, understood, and accepted.

The underlying principles and parameters must involve maintaining quality of output and stable and productive SSB operation, while at the same time gaining experience with new practices and adjusting final MG proposals as necessary. This underscores our previous recommendation to adopt a piloting and testing approach, which would allow for change while controlling other quality and capacity variables.

The objective of the transition plan should also explicitly include the continuous monitoring and evaluation of risks of **unworkable, impracticable or counter-productive change** that inadvertently negatively affects stakeholder confidence, standard setting speed, adoption, or efficient SSB operation.