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June 27, 2012

Mr. Fernando Restoy
Chairman, Monitoring Group

By E-mail: Piob-MonitoringGroup@ipiob.org

Dear Mr. Restoy:

Re.: Public consultation on the governance (with special focus on the organisational aspects, funding, and roles) of the Monitoring Group, the PIOB and the standard-setting boards and Compliance Advisory Panel operating under the auspices of the IFAC

We would like to thank you for the opportunity to provide the Monitoring Group with our comments on its public consultation on the governance (with special focus on the organisational aspects, funding, and roles) of the Monitoring Group, the PIOB and the standard-setting boards and Compliance Advisory Panel operating under the auspices of the International Federation of Accountants (IFAC).

The Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association] (IDW) represents the Wirtschaftsprüfer [German public auditors] (WP) profession in Germany and is responsible for the issuance of IDW Auditing Standards, which transpose the International Standards on Auditing (ISAs), and other technical professional standards in Germany for the WP profession. The IDW is a full and founding member of the International Federation of Accountants (IFAC) and of the Fédération Experts Comptable Européen (FEE). Together with the Wirtschaftprüferkammer [Chamber of Public Auditors] (WPK), the IDW has been a sponsoring organization of members of the International Auditing and Assurance Standards Board (IAASB) and its predecessor, the International Auditing Practices Committee (IAPC), of the International Ethics Board for

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
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Professional Accountants (IESBA), and of the IPSAS Board, since their inception.

We believe that the IDW is recognized by relevant Ministries of the German government and German regulatory authorities, and by the European Commission, as a technically competent participant in discussions with them about auditing and auditors in both the long-term interests of the profession and the overall public interest, which we believe to be in consonance in the long run. We believe that this is so because, ultimately, auditors as a profession must provide services that deliver real added value to users in the public interest as a prerequisite for the long-term success of the profession. We have written our comments on the public consultation from this perspective.

While the public consultation addresses broad issues in relation to all public interest activity committees (PIACs) of IFAC, their Consultative Advisory Groups (CAGs) and to the Public Interest Oversight Board (PIOB), it focuses on the IAASB (auditing and assurance) and IESBA (ethics). In our comments we will focus on the impact of the recommendations of the Paper on the IAASB, since these comments may also apply in an analogous fashion to the other PIACs. However, as a whole, the public consultation does not adequately address the importance of education (IAESB).

Before responding in the Appendix to this letter to each of the questions posed in the public consultation, we provide some general comments in the body of this letter.

General Comments

We believe that some of the statements in the public consultation appearing to form the justification for subsequent contentions therein represent non sequiturs or false causes, or in some cases lack evidential support.

In the executive summary, the statement is made that “in relation to independence, the document deals with the possible conflicts of interest that might arise from the fact that employees of audit firms still have a very significant involvement in standard-setting”. We do not deny that such conflicts of interest might exist, but as a statement on its own it conveys the impression in the executive summary that the only important issue in relation to the composition of standard-setting boards is significant practitioner involvement and the potential conflict of interest from this. The statement conveys an entirely biased view of the matter, since it does not recognize that members from other

stakeholders may have also have conflicts of interest of a different sort with the potential added handicap of less competence.

Of particular concern is the lack of underlying analysis and logic in the subsection of the Introduction entitled “Background – lessons from the financial crisis”. A bold statement is made in the first sentence of the third paragraph of that subsection that “the current financial crisis provides a new impetus to strengthen the governance of international standard-setting activities for accountants”. Without in any way suggesting that there is no room for improvement in audits and auditor ethics, and in the standards governing these activities and governance over the standard-setting processes for those standards, there is in fact little – if any – evidence that the financial crisis was caused by deficient audits or auditing standards, a lack of auditor ethics, or deficient governance processes over standard-setting. Why, therefore, the financial crisis should provide an impetus to strengthen such governance is unclear: no logical link is established between the financial crisis and such governance.

In fact, the financial crisis might also be seen as having been caused – at least partly - by a systematic failure of regulators (i.e., those member bodies of some of the bodies comprising the Monitoring Group) and governments to properly regulate financial markets to prevent the creation of a financial bubble based on substandard financial products (whether asset-backed mortgages, synthetic derivates, or low quality sovereign debt, etc.). The Monitoring Group can afford to be a little more humble when seeking to throw the first stone. In this context, the question that IFAC and its PIACS ought to be asking themselves is whether it increases the credibility of their standard- setting activities to have the blessing of the Monitoring Group, or whether IFAC should be seeking the imprimatur of bodies less tarred by the financial crisis.

The following three sentences in the noted paragraph betray the shallowness of the analysis undertaken to justify the final sentence in that paragraph, which questions the adequacy of the governance framework under which auditing and ethics standards have been created. The second sentence of the noted paragraph states that “Stakeholders expect the auditor to provide them with assurance concerning the fair presentation of the financial statements”. This is a true, but not fair, statement. First, stakeholders may have many expectations, but that does not mean that all of them are worthy of fulfillment. Second, auditors do not “provide” assurance – auditors obtain assurance (see the IAASB Assurance Framework, ISAE 3000 and the ISAs) and seek to communicate the assurance obtained, because the assurance obtained can never be precisely

communicated, and that communicated is never that attributed by the recipients of that communication thereto. Third, and most importantly, “fair presentation” cannot be understood without the underlying context of financial reporting standards, since for example under IFRS, it is only in extremely rare circumstances that auditors would judge application of the financial reporting standards to result in inappropriate recognition of measurement that cannot be remedied by disclosure alone. By ignoring the role of financial reporting standards, the second sentence appears to be suggesting that auditors generally apply, or should generally apply (as opposed to rarely), a “fair presentation” test beyond the strictures of financial reporting standards, which is an unreasonable proposition because there would be no objective criteria for determining appropriate financial reporting treatment. Hence, the second sentence provides no basis for questioning the governance of audit standards setting processes.

The third sentence states that stakeholders “may be interested in assurances [*sic*] …about other issues, such as fraud or the responsible behavior with regard to environment, governance and social matters.” This is true, but is also a non sequitur because none of these issues relate to audit or ethics standards: they relate to what ought to be reported by management or those charged with governance and then perhaps subject to an assurance engagement. On this basis, the beginning phrase of the fourth sentence “In this sense” is without content. Consequently, the noted contents of the third sentence do not provide a basis for questioning the governance of audit standard-setting processes either.

The beginning of the third sentence addresses stakeholder interest in assurance regarding the going concern status of the entity and ties into the example in footnote 4 of the fourth sentence and the subsequent assertion in that sentence that “public expectations of what the financial statements and the auditor’s opinion provide appear not to have been completely fulfilled …”. First, it is management’s responsibility to disclose in the financial statements the going concern status of the entity – not that of the auditor. Only if management has not made adequate disclosures about that status must auditors qualify their opinion or express an adverse opinion. Consequently, at variance with the assertion in footnote 4, if management has made adequate disclosures, no qualification with respect to going concern is required – indeed, it would be entirely inappropriate to qualify the opinion on the financial statements if disclosure is adequate because the financial statements are “right”. Second, if there are material uncertainties (in the U.S., substantial doubt) relating to the entity’s ability to continue as a going concern, if (and only if) disclosure thereof in the financial statements is adequate, auditors are required to include an

emphasis of matter paragraph on such material uncertainty. However, such an emphasis of matter paragraph and related disclosures are not necessary if management or third parties (such as governments) have taken measures to mitigate that uncertainty. So for example, shortly after the commencement of the financial crisis, banking oversight authorities in some jurisdictions clarified to management and auditors prior to the issuance of the financial statements and the auditor's report that the governments of those authorities would provide the necessary support to the financial institutions to prevent their illiquidity or insolvency (which they subsequently did), and that therefore such disclosures and emphasis of matter paragraphs were not desired because they would cause a "run on the banks". We find it to be somewhat hypocritical that those same banking oversight authorities, which are represented in the Monitoring Group, are now accusing auditors of not having qualified their auditors' reports for going concern disclosures, or not having included an emphasis of matter paragraph in relation to material uncertainties, prior to the extension of promised government support.

The fourth sentence states that "public expectations of what the financial statements and the auditor's opinion provide appear not to have been completely fulfilled – the "expectation gap". This is only a partly true, but definitely not fair, statement. First, public expectations of the financial statements relate to the "information gap", not the expectations gap. Second, public expectations with respect to information about an entity can never be fulfilled by the financial statements or any other form of reporting because there will always be a gap between what is reported and what is, and the public will never have access to all entity information. Third, it is not necessarily the role of auditing, auditing standards, and auditors to reduce the information gap: that is properly the role of corporate reporting (financial statements and other reporting) through management and those charged with governance in accordance with reporting – not auditing – standards. Fourth, the expectation gap is composed of a number of components – some of which can be narrowed and some not. In particular the gap between what the public expects and what can reasonably be expected of audits (the so-called "reasonableness gap" component of the expectation gap) can never be completely eliminated. It is therefore a non sequitur to claim that because public expectations have not been completely fulfilled, questions ought to be raised about the governance of auditing and ethical standards.

The fifth and final sentence of that paragraph raises the question of "whether audit and ethics standards have worked sufficiently well and how they have been applied by extension raises the question about the suitability and

adequacy of the current governance and regulatory framework under which the auditing mandate operates". First, there is little or no evidence that audit and ethics standards as a whole have not worked sufficiently well. Second, even if they have not worked well, there is no evidence that this is due to deficient standards as opposed to deficient execution (i.e., how they have been applied), which is not a standard-setting governance issue. Lastly, even if the standards were deficient, this does not imply that the current governance and regulatory framework is unsuitable or inadequate – but it would be cause to investigate whether this is so. However, the public consultation does not represent such an investigation.

Overall, the public consultation makes a chain of assumptions and logical leaps with little or no evidence to support the conclusion that questions need to be raised about the suitability and adequacy of the governance of auditing and ethics standard-setting. This is tragic because it may lead to the Monitoring Group (MG) seeking to "fix" something that is not broken, and thereby actually cause the decline in quality in auditing and ethical standard-setting that it seeks to avoid. We are not opposed to change and to reasonable discussions about improvements that can be made to the governance arrangements over auditing, ethics, and education standard-setting, but we do believe that such discussions should be based on evidence and objective analysis.

We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Wolfgang P. Böhm
Director Assurance Standards,
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APPENDIX :
Responses to the Questions Posed

Q1: Do you consider it necessary to enhance representation of the public interest? If so, which additional actions, apart from the appointment of an independent IESBA Chair and redefining the nature of non-practitioner board members, would you suggest to reinforce the mechanisms to safeguard the public interest?

We would like to point out that the Nominating Committee has already applied the new definition of non-practitioner in its selection of candidates for 2012, and that an independent IESBA Chair has already been selected for the near future.

In this context, the question posed above is not neutrally worded, because it asks whether enhancement of public interest representation is necessary and whether additional actions could be suggested to "reinforce mechanisms to safeguard the public interest" – not whether the current degree of public interest representation is appropriate, and what actions are suggested to make it appropriate. It seems to us that the Monitoring Group is seeking to use "motherhood" phrases such as "enhance" in connection with "public interest" and "safeguard the public interest" to prejudice the uninitiated non-professional accountant stakeholder to say "yes", it needs improving", for would anyone without a deeper knowledge of current conditions say "no, it need not be improved"? As any academic with survey experience would point out, the responses would not be valid because the questions have not been neutrally posed. A valid question is therefore, does the current structure of standard-setting appropriately safeguard the public interest?

Furthermore, the discussion of the structure in the text prior to Questions 1 and 2 does not provide a neutral depiction of the situation. In particular, the text notes only two key elements to achieve the goal of stakeholder confidence in the quality of standards: independence and accountability. This is ludicrous, because it suggests that if the standards are independently and accountably set, the competence with which they have been set is irrelevant.

We note that as part of the standard-setting process, users of assurance reports must advocate the nature and extent of assurance desired, if any, whereas, based upon its expertise, the profession must circumscribe the nature and

extent of assurance technically deliverable in the context of user desires and the costs that would be incurred. Ultimately, successful standard-setting involves an understanding between the profession and other stakeholders about whether the engagements designed by the standards meet user needs in terms of costs and benefits and whether, based upon its expertise, the profession is of the opinion that such services are technically deliverable. In this sense, the IAASB is a "technical board" in the first instance, rather than a "political board", but it does have the political responsibility to ensure that the public interest is met by the standards it promulgates.

Consequently, without the decisive influence of both the profession and other stakeholders in IAASB standard-setting, the quality and acceptability of the standards, and hence, whether they would meet the public interest, would be questionable. For these reasons, technical competence is just as important as independence and accountability.

The text then goes on to claim that the governance structure should provide for a standard-setting environment that is independent of and protected from vested interests. The text then points to the "non-controlling but significant involvement in standard-setting" of audit firms and that "this could raise doubt about possible conflicts of interest – both actual and perceived – which are inherent in the current scheme".

We would like to point out that the profession has a vested interest in the long-term value of the primary service it provides (audit) and that therefore there is no long-term conflict of interest between the profession and the public. Even if there was, replacing some or all of the remaining practitioners would not reduce conflicts of interest: it would just shift the nature of the conflict of interest to other stakeholders, who would then write standards that are technically weak, or even worse, technically impossible to meet because they would write standards that meet their expectations, even if these expectations are unreasonable. Having a balance between practitioner and non-practitioners is the best solution to the development of standards that meet the needs of both users and practitioners.

Given the oversight of the PIOB (without any practitioners) under the monitoring of the Monitoring Group (no practitioners), the input from the CAGs (virtually no practioners), the leadership of a non-practitioner chair, at least half of the Board members being non-practitioners, and all members (including practitioners) being held to set standards in the public interest, it is hard for anyone to make a convincing claim that the public interest is not adequately safeguarded. Therefore, further enhancements to protect the public interest are not necessary.

Q2: In the long term, would you favour a different and fully independent standard-setting model completely outside the IFAC structure and if so how could such a structure be funded?

We note that under the current model, the standard-setting Boards ARE fully independent (in fact) in terms of their standard-setting. It is therefore unclear to us what the benefit in terms of independence in fact would be of having the Boards outside of IFAC. The question posed is therefore a leading one, because uninitiated readers will assume that the standard-setting boards are not independent in fact. If the issue is one of independence in appearance, then that can be solved by having IFAC be less prominent in communications relating to the standard-setting boards. It is not clear to us who would fund the international boards outside of IFAC. We would like to point out that the auditing standards of the IAASB and the Code of Ethics of the IESBA under the auspices of IFAC have enjoyed great success internationally, in part due to the support of IFAC through its Statements of Membership Obligations and the Compliance Advisory Panel

Q3: Do you consider the current three-tier system adequate for achieving its objectives, or an alternative model could be more adequate? In the latter case, which model would you suggest?

Given the fact that there are a number of important bodies beyond three in the noted system, it is more appropriate to speak of a “multi-tiered” system, than a three-tier system. In particular, in addition to the MG, the PIOB, IFAC, and the PIACs, there are also the CAGs. Each has an important, but different, role to play:

- The PIACs are responsible for setting technical standards in the public interest
- The CAGs are responsible for providing political and high level technical input from a wide range of international stakeholders on the standards, standard-setting processes and strategy and work plan
- The PIOB is responsible for ensuring that the standard-setting process, the process for selecting PIAC members, and the process for determining the strategy and work plan takes place in accordance with the public interest

- IFAC is responsible for supporting the work of the PIACs financially and with other services, and by promoting the use of the standards worldwide
- The MG is responsible for ensuring that the PIOB fulfils its public interest role and for ensuring that the overall system meets the objective of promulgating high quality standards in the public interest

We believe that the current multi-tier system to be adequate for achieving its objectives because each of the bodies mentioned has a clear and complementary role. We would be very concerned if the MG were to short-circuit the process by intervening more directly into the standard-setting process because then the PIACs would no longer be independent – they would be subject to the interests of the members of the MG, the members of which are an interest group, too. If the members of the MG have concerns about additional opportunities to tackle challenges arising from the changing environment, they have the opportunity currently to make these issues known through the CAG, to the PIOB, or in outreach meetings with the Chairs of the PIACs.

Unless there is clear evidence that the standards issued by the PIACs are deficient as a whole, we believe that the MG has no case for changing the structure, and may in fact endanger a process that is working well.

Q4: Would you support the IPSASB being subject to PIOB oversight? Why? What conditions, if any, would you impose on such oversight? Would you see as a factor to take into account the fact that IPSASB deals with accounting rules instead of auditing ones?

As a matter of principle, we would support the IPSASB being subject to PIOB oversight because the IPSASB is clearly setting financial reporting standards for the public sector in the public interest and therefore ought to be subject to public interest oversight. This has become a particularly important issue in the context of the current sovereign debt crisis, because transparency in financial reporting by governments is a prerequisite for identifying and dealing with their financial problems before they become acute. We would not support a public sector exclusive model because it is important that the body overseeing the standard-setting process of the IPSASB not be dominated by public sector bodies, which are interest groups too and have their own agendas. The entire private sector (businesses and individuals) has a vested interest in public sector financial reporting, too. By having the PIOB engage in such oversight, the oversight

would be independent of too much public sector influence because private sector stakeholders are represented on the PIOB.

We do not believe it to be an oversight issue that the IPSASB promulgates financial reporting standards rather than auditing ones: what is important is that an excellent oversight system, such as the one devised by the MG and IFAC be applied to the IPSASB. Once the funding issues have been resolved (which are comparatively small compared to other funding issues related to oversight), the benefits of PIOB oversight significantly outweigh the challenges.

Q5: Do you see merit in having a "Compilation document" for the whole structure? In this case, which alternative would you prefer for organising the structure and nature of the Compilation document?

We agree with the statement made in the public consultation that the structure and status of the monitoring, oversight, and standard-setting structure is not clear to many stakeholders, which is why there appear to be issues about independence in appearance. For this reason, a compilation document that pulls together the relevant contents of the individual documents forming the basis for the structure (IFAC Constitution, FOF Constitution, PIOB Terms of Reference, PIAC terms of reference, and MG "constitution") as the basis for a communications instrument may be very helpful. However, such a compilation document should only reflect the provisions in the underlying documents – not change them.

For these reasons, we do not believe that a stand-alone charter establishing the governance of the whole structure is appropriate, since a stand-alone charter would invariably lead to changes to the structure with unintended consequences. A compilation, on the other hand, only reflects the underlying documents without any separate authority. For these reasons we believe that such a compilation can be undertaken by the PIOB and be communicated by that body on behalf of all of the bodies involved.

Q6: Given the breadth of the current mandate, would you consider it helpful to modify the name of the structure to improve its visibility? In this case, what name would you suggest?

Branding of a structure can be important to convey certain messages, such as the safeguarding of the public interest through the independence of standard-setting boards and public interest oversight. At present, there is no name or

brand for the entire structure, so the question about “modifying” the name seems to be inappropriate: it is more about creating a name.

It is also important that a title as a brand be relatively short. “International Public Interest Standard-Setting Architecture for the Accounting Profession” seems an appropriate title. However, it would not be appropriate to attach this title to the bodies in that architecture because the titles would become unwieldy. Furthermore, these bodies are already well-known by their current titles.

Q7: Do you agree with the proposal that the MG should have a more strategic role?

It is unclear what is meant by “a more strategic role”. We believe it to be appropriate for the MG to reconsider its activities, but whether that implies a “more strategic role” depends upon what is meant by “strategic”. In our view, it is therefore not useful to attempt to answer the Question 7, but rather, to answer in Question 8 below the detailed proposals in the bullet points of the text prior to Questions 7 and 8.

Q8: Do you agree with the objectives proposed and, specifically, with the MG having the possibility of conferring with the PIOB on the PIACs’ agendas and receiving appropriate feedback?

It appears to be more fruitful to attempt to respond to the objectives that the MG would pursue as set forth in the two bullet points prior to Questions 7 and 8, than to answer this question directly. In this respect, providing more input and guidance to the PIOB about recent developments in regulatory issues and changes in the economic context, trends and concerns appears to be a reasonable activity, and we ask ourselves why this is not already occurring, since the PIOB needs this information to consider the strategy and work plan of the PIACs. However, since the standard-setting boards are independent of IFAC, we question what the purpose would be of providing such input, and guidance about the matters noted to the IFAC International Regulatory Liaison Group. If the purpose is to have the IFAC International Regulatory Liaison Group use this information to inform IFAC’s strategy, then this is appropriate, but this is not relevant at all to the PIACs because the IFAC International Regulatory Liaison Group has no role vs. the PIACs.

We thought that the MG already monitors its PIOB oversight methodology, including regular benchmarking against relevant organizations to continually

improve those methodologies. If this has not been taking place, we ask ourselves why not. However, the words “giving regard to the PIOB’s consideration of whether due process in the standard-setting activities of PIACs is robust and responsive to the public interest” suggests that the MG would actually seek to influence the PIOB’s independent consideration of whether the standard-setting due process of PIACs is robust and responsive to the public interest. In our view, the MG should refrain from engaging in an activity in which the PIOB has greater expertise due to its being closer to the actual due process activities of the PIACs. Just because MG suggestions have been appropriately considered by the PIACs, but not resulted in changes to PIAC pronouncements, is not a reason for the MG to cause the PIOB to reconsider the appropriateness of the due process. All stakeholders (preparers, auditors, users, regulators, etc.) have an equivalent stake in the functioning of the due process.

As we mentioned in our response to Question 3, we would be very concerned if the MG were to short-circuit the process by intervening more directly into the standard-setting process through closer involvement with the PIACs because then the PIACs would no longer be independent – they would be subject to the interests of the members of the MG, the members of which are an interest group, too. As we pointed out, if the members of the MG have concerns about particular issues, they have the opportunity currently to make these issues known through the CAG, to the PIOB, or in outreach meetings with the Chairs of the PIACs. There is no need for an additional mechanism for additional meetings with the Chairs or the need to reference public interest issues through the PIOB for consideration on Board agendas.

The right of receiving specific feedback on whether the topic was added to the agenda or otherwise the reason justifying its omission, would in our view impair the independence of standard-setting boards in both appearance and fact. It would detract from the credibility of the standard-setting process if some stakeholders were given special treatment in this respect. The fact that the MG is making such a recommendation in a Paper that it has written itself could be interpreted by some as unseemly in that the MG is using its position, in relation to its public interest role to assess the effectiveness with which IFAC has implemented its reforms, to garner special advantages over other stakeholders.

Q9: Do you agree with the suggested ways of improving the communication activities? Would you consider it useful for the MG to have in the special occasions above described direct involvement with PIACs?

On the whole, we would welcome the MG improving its communication activities because this would clarify to the public the nature and extent of its involvement in the standard-setting architecture.

However, as we have noted in our response to Questions 3 and 8, we would be very concerned about additional direct involvement with PIACs for the reasons noted in those responses.

Q10: Do you have any specific suggestions on how liaison with investors could be improved? In this sense, do you see merit in some portions of the MG meetings having the public in attendance?

We do not have any specific suggestions on how liaison with investors could be improved. While transparency is often considered important, it is difficult for us to judge whether having the public in attendance at MG meetings would be useful.

Q11: Would you find it useful that the MG engages with organisations representing governmental institutions? Would the G20 be the most appropriate or, should others bodies be considered instead?

On the whole, we would find it beneficial for the MG to engage with organisations representing governmental institutions because it would help broaden the MG's consideration of public interest issues in relation to governance of standard-setting. We are not in a position to provide advice as to whether the G20 or other bodies would be most appropriate.

Q12: What is your opinion about the current composition of the MG? (i) Do you believe that other organisations (i.e., national or regional regulators) should or could be represented in the MG? If so, which criteria do you think new members should fulfil to become MG members? (ii) Should a maximum be set to the number of MG members? (iii) Would you favour a change on how the Chairperson is appointed?

It is unclear to us whether the current composition of the MG is appropriate. We would support having the MG develop clear criteria for membership, so that it is clear what kinds of organizations ought to be members – and more importantly, what kinds of organization should not be members. On the whole, we do not believe that national or regional regulators ought to be included, because the MG should represent the international organizations of those national or

regional regulators. We are not in a position to give advice on the other criteria that might be appropriate for membership in the MG, but would suggest that the MG not be made too large, or it would become unwieldy. How the chairperson is appointed ought to be a matter for the MG to decide.

Q13: Do you see a problem in MG members appointing full time employees of organisations represented in the MG as PIOB members?

We do not see a problem with full-time employees of organizations in the MG being appointed as PIOB members, just as we do not believe it to be appropriate to object to having full-time employees or partners of other organizations being members of the PIACs or their CAGs: it will be difficult to find individuals who are not fully active otherwise to serve in these positions. Furthermore, such persons benefit from the access to information and other support in their organizations. However, PIOB members should be subject to the same "independence declaration" to which the members of the PIACs are subject, and their organizations should be subject to the same "no undue influence" declaration to which the employers and the sponsoring organization of PIAC members are subject.

Q14: Would you consider convenient to avoid direct hierarchical relationship between the PIOB and the MG members?

We would be very concerned if there were to be a hierarchical relationship between PIOB and MG members because the PIOB is supposed to be acting independently and in the public interest. The MG's role is to ensure that the right persons and due processes are in place to enable the PIOB to fulfil this role.

Q15: Do you think that the roles and responsibilities of MG and PIOB should be further clarified? Do you have specific suggestions regarding which areas this clarification should address?

We do believe that it is necessary that the roles and responsibilities of the PIOB and MG be further clarified – in particular, to safeguard the independence of the PIOB. If the PIOB were not to be independent of the MG in matters other than the selection of its members and due process, there would be no need for a PIOB: the MG could undertake the PIOB's role directly. The PIOB should be independently ensuring that the public interest is being served by the PIACs by addressing the selection of members, strategy and work program, and due

process of the PIACs. In this context, we do believe it to be useful for the MG members to give presentations of the latest regulatory developments and changes in economic context to provide informational context to the PIOB members for their work – but not "guidance", which intimates that the MG is directing the work of the PIOB. For this reason, we are concerned with the MG providing "input" on the "strategic direction" (which implies directing the PIOB's work at a high level) of the PIOB. What would that "strategic direction" entail and what would it be in relation to, if not to address substantive issues beyond governance and due process that are actually within the remit of the PIACs? As we have said before, there is nothing wrong with the MG making information available or its views known to the PIACs through the PIOB, through the CAG, through comment letters, or through the outreach activities by PIAC chairs, but not to "direct" these bodies or the PIACs.

Q16: Do you see merit in the PIOB undertaking a regular review of its due process and oversight framework through its strategy document?

We do see merit in having the PIOB undertake a regular strategic review of its due process and oversight framework through its strategy document to ensure that its due process and oversight framework continues to be fit for purpose. However, a review every two to three years is overkill: it does not allow the PIOB to properly design, implement, and operate changes to its due process and oversight framework and to determine their long-term effects before needing to undertake another review. Such "short-termism" is not conducive to a stable, well-operating oversight system. In our view, a regular review should take place not more than once every five years, unless there is clear evidence that a non-regular review is needed to address significant problems that arise due to major changes in circumstances. Such non-regular reviews should be rare (i.e., if they occur more than once every twenty years, then the institution of non-regular reviews is being abused).

Q17: Do you see merit in the PIOB periodically producing a strategy document that would supplement the yearly business plan and budget? What should the involvement of the MG be in the production of these documents?

We do see merit in the PIOB periodically producing a strategy document that would supplement the yearly business plan and budget, but a strategy should be long-term and clearly be distinguished from short-term goals. This means

that a strategy should set out long-term objectives (i.e., for the next ten to twenty years) and a proposed strategy over the medium- (five years) and long-term to achieve these objectives. Such a strategy document would need to be produced at most once every five years (if it is produced more often, it is no longer a long-term strategy – see below). This would not preclude the annual business plan from reviewing progress in implementing the strategy to achieve the objectives. The MG needs to remember that the shortest standard-setting projects at the IAASB take at least two to three years; major projects that address fundamentals need to take longer (up to five to six years). This is not out of line with the time needs for projects at the IASB (indeed, the IAASB actually takes much less time to complete projects on average that the IASB). In any case, international standard-setting does require more time than at a national level because there are more cross-jurisdictional issues to consider. This is the reason why a long-term strategy of shorter than five years for the PIOB is not a long-term strategy at all, but just represents the short- and medium-term goals of a “work program”.

In this context, the consultation paper suggests that the PIOB reflect on the meaning of “public interest”. This is one of the most challenging issues for political philosophers and political economists: hence, we are not convinced that the PIOB will be able reach universal solutions in this matter. What is more important is that the PIOB asks the right questions in this respect: the IFAC paper on the meaning of the public interest might be a good starting point for this activity. Furthermore, since the oversight process and due process of the PIACs is state-of-the-art, there will be little benefit in benchmarking the process against that used by other organizations, such as the IFRS Trustees, since their processes are much more rudimentary than those used in the PIACs.

In our view, the role of the MG in the production of a strategy document is much like that of non-executive directors (those charged with governance) in corporate governance: The MG should examine the process by which the long-term objectives and strategy are developed and determine whether these are in line with the PIOB’s public interest mandate, and should cross-examine the strategy chosen to achieve the objective to ensure that the strategy was developed in a robust manner.

Q18: Do you think that the current composition of the PIOB could be enhanced? Would you consider convenient that the PIOB’s composition is reviewed each time a new body becomes full member of the MG?

At the present time, we are satisfied with the current composition of the PIOB, and are at a loss as to how it could be further enhanced. Certainly, it may be convenient that the PIOB's composition be reviewed on a regular basis, but we cannot give advice as to whether this would be appropriate when a new body becomes a full member of the MG.

Q19: Would you consider the current composition of the PIACs appropriate? Do you see merit, in the context of a second effectiveness review, in exploring the idea of having a majority of non-practitioners and a majority of public members?

We consider the current composition of the PIACs to be appropriate because there needs to be a balance between those applying the standards and those using the product of those standards.

We would like to point out that there is no evidence demonstrating that standards had been issued with the effect of furthering auditor self-interest under the current composition. We are convinced that the MG underestimates the impact on the quality of standards of the nature and extent of expertise involved in the standard-setting process – in particular by those who apply the standards in practice.

In this context, the fact that the MG is bringing up this issue of practitioner representation again in this public consultation (and in every paper it produces on this issue) intimates a discomfort with the participation of the profession in the standard-setting process. It is not clear from the public consultation what the ultimate objectives of underlying questions are, i.e., what is the endgame? Is the ultimate objective to obtain the highest quality standards possible set in the public interest, or is the actual quality of the standards of secondary importance compared to addressing the supposed perceptions of some stakeholders that ample auditor involvement in setting auditing and ethics standards is per se undesirable?

We believe that no one would dream about setting standards for medical surgery, engineering processes, or legal proceedings without a preponderance of surgeons, engineers or lawyers, respectively, in bodies promulgating such standards because such standards, while having public interest objectives, are "technical standards" in the first instance – not "political standards". Auditing is also a highly technical, complex service requiring years of education, training and experience. Having stakeholders beyond those applying the standards substantially participate in technical standard-setting is critical to ensuring that

standards are set in the public interest rather than in the sole interest of those who are applying them. However, further increasing the proportion of such stakeholders such that they actually constitute a greater preponderance of standard-setting boards may lead to the degeneration of technical standard-setting boards into political bodies that know very little about the details of what they are regulating (an example of the difficulty that non-practitioners have with the needed technical precision in auditing standard-setting becomes apparent when a technical analysis is performed on some of the wording used in Article 22 on the auditor's report in the regulation for audits of PIEs as proposed by the EU Commission). In addition, by reducing the influence of the profession for supposed "conflicts of interest", the MG would only be increasing the conflicts of interest arising from the other stakeholders – that is, replacing one set of conflicts of interest with another.

This is why we are convinced that a balance between those who apply the standards and those who use the product of those standards is crucial to high quality standard-setting in the public interest. We therefore see no merit at all in exploring the idea of having a majority of non-practitioners and a majority of public members.

Q20: Do you consider best practice a nine years period for rotation of the representatives of CAG member organisations?

We are concerned that periods of rotation for the representatives of the CAG member organizations do not make sense: the members of the CAGs are supposed to be providing the views of their organizations to the PIACs. Consequently, it is unclear to us why a period of rotation is necessary for representatives of CAG member organizations. Furthermore, the longer a representative is a member of a CAG, the greater their expertise in dealing with the issues arising from the PIAC involved. New blood will be infused into the CAG on a regular basis by attrition, and some long term "old blood" is useful so that the CAG retains its "institutional memory".

In this context, overall, our experience on the IAASB has convinced us that the maximum six year term of service for PIAC members is too short. It takes at least two to three years for most PIAC members to become adequately cognizant of the details of the interconnections between pronouncements, and since the maximum term of service has begun to bite (and ex-Board members are no longer permitted to be TAs), we note a decline in the institutional memory of the Board, which is not conducive to internally consistent, high quality standard-setting. As noted, some attrition occurs anyway without maximum

terms of service, so having longer maximum terms would not prevent the infusion of fresh blood onto the PIACs and would safeguard PIAC institutional memory. This becomes particularly important for long-term projects that might take more than just three or four years.

Q21: Would you agree that it is not realistic at the current time to attempt to alter the funding structure of standard setting activities in any substantial fashion?

At the present time, we agree that it is not realistic to attempt to alter the funding structure of standard-setting activities in any substantial fashion. However, consideration does need to be given to finding external funding for the PIOB, since having most of the funding come from IFAC impairs the PIOB's independence in appearance – though, given the safeguards in place – not in fact. However, other funding must become available before seeking to replace IFAC funding.

Q22: Do you consider appropriate that IFAC finances the largest part of the PIOB budget? If not, do you consider appropriate that IFAC launches an external fundraising having some contributions of the MG members in the mean time?

As noted in our response to Question 21, we do not consider it appropriate that IFAC finance the largest part of the PIOB budget, but recognize that other funding organizations need to "step up to the plate" first. In our view, it is NOT the responsibility of IFAC to find external funding for the PIOB: that is the responsibility of the PIOB and of the MG. To this effect, the MG has received a "free ride" from IFAC by not having funded the PIOB. We therefore would welcome MG funding.

Q23: Do you think it feasible to have a similar funding structure in place for the PIOB to that in place for funding the IFRS Foundation?

We are not convinced that PIOB funding will be as easy to raise as funding for the IFRS foundation because industry is less interested in auditing standards than in accounting standards. We are therefore sceptical that a similar funding structure can be established.

Q24: Do you see the need for and/or merit in having a permanent Secretariat for the MG? In this case, do you think IOSCO should provide resources for a permanent Secretariat to the MG?

We are not convinced there is a need for a permanent secretariat or that this would be advantageous for the PIOB or PIACs, or for the quality and independence of standard-setting. Our experience has been that once an institution has permanent staff, it creates papers (i.e., proposals for change of some sort). Since strategic change ought to be a long-term process, and the work of the PIOB needs to be evaluated at most once per year and its strategy at most once every five years, we are concerned that creating a permanent secretariat would lead to the MG issuing all sorts of proposals throughout each year in future years. The PIACs are already spending an inordinate amount of time of due process and political issues, rather than standard-setting, due to the initiatives of various regulators and other parties around the world.

The MG should allow the PIOB to do its work on an annual basis free from the continual interference that would be caused by an MG with a permanent secretariat that then would “second-guess” the work of the PIOB or, even worse, “second-guess” the work of the PIACs. In addition to costing more money, this would reduce the independence of both the PIOB and the PIACs. Rather, if resources and funding are available for a permanent secretariat of the MG, the MG should make those resources and funds available to the PIOB and thereby help reduce the PIOB’s dependence on IFAC funding.

Q25: How do you think the governance of the international auditing, ethics and education standards setting process could improve audit quality? What are the main objectives that those responsible for governance should take into account?

Upon reflection, the governance of international auditing, ethics, and education standards setting processes improves audit quality when such governance safeguards the independence of those standard-setting boards – not only from the profession, but also from other interest groups, including the MG – by ensuring that there is a balance between those who apply the standards and those who use the product of those standards. The governance process must ensure that the right individuals in terms of technical competence are selected for the PIACs and that the PIACs have the due process in place to ensure the public interest is served by the standards that they issue. Furthermore the governance process should ensure that oversight of these matters through the PIOB is effective. These are the objectives that those responsible for

governance ought to take into account. In our view, the current structure largely fulfils these roles. There is a great danger in seeking short-term change to this structure without having examined the long-term consequences.

Q26: What is your opinion about the current structure? Do you think the current structure is appropriate in order to improve audit quality? If not, what changes, suggestions or remarks would you propose?

In our opinion, the current structure works well: there is no evidence that on the whole the standards set are not of high quality or are not in the public interest, or that the PIACs are not being responsive to rapid changes in the environment. Consequently, we believe that the current structure is appropriate in order to improve audit quality. However, this does not mean that further improvement cannot be considered. However, reducing the independence of the PIOB or the PIACs from the MG, or disturbing the balance between those who apply the standards and those who use the product of those standards will ultimately reduce the quality of those standards and should not be among the changes considered.

Q27: Do you agree that the current levels of empowerment and responsibility of the bodies that compose the current structure (MG, PIOB and PIACs) are appropriate? If so, do you have any suggestions for improving the dialogue and interaction between the different bodies? If not, how these levels of empowerment and responsibility could be improved?

We agree that the current levels of empowerment and responsibility of the bodies that compose the current structure (MG, PIOB, PIACs,CAGs, and IFAC) is appropriate. However, improving the dialogue between these bodies is certainly worthy of consideration, as long as it does not lead to the MG directing the work of the PIOB or of the PIACs. Therefore, we do not believe that the levels of empowerment and responsibility need changing, other than perhaps clarifying them.

Q28: Do you think that there is any other overall structure that could achieve improvement in audit quality more efficiently? If so, what could they be and how might they be financed?

We are not convinced that there is an overall structure at the present time that could achieve more than has been achieved in audit quality more ***effectively***, which is more important than efficiency. Furthermore, we are not convinced that other forms of financing will become available in the near future.