

Michael E. Bradbury PhD, FCA

Professor
School of Accountancy
Massey University
Private Bag 102 904 NSMC
Albany Campus
Auckland, New Zealand

Tel: +64 9 4140800

Fax: +64 9 4418133

Email: m.e.bradbury@massey.ac.nz

To the Monitoring Group

Monitoring Group Consultation (Document): Strengthening the Governance and Oversight of the International Audit-related Standard-setting Boards in the Public Interest

I welcome the opportunity to comment on the Monitoring Group's proposals. In the appendix to this covering letter I summarise my experience in standard setting.

In this submission I make several comments related to 'public interest'. I then make a comment on board representation and on the need for the proposals.

I have not responded to the detailed questions in the consultation document, primarily because the most appropriate framework will depend on how 'public interest' is defined. Until a definition of 'public interest' has general acceptance, any structural proposals are premature.

Sincerely



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Appendix: Experience in Standard Setting

I am currently a board member of the New Zealand External Reporting Board (XRB). The XRB is an independent Crown entity responsible for developing and implementing an overall strategy for financial reporting standards and auditing and assurance standards. However, this submission is made in a personal capacity and the views expressed are my own and do not represent positions of the XRB or any of its sub-boards (NZ AuASB and the NZ ASB).

I have had extensive involvement in national standard setting. I was a member of the (New Zealand) Financial Reporting Standards Board from 2000 to 2009; the Financial Accounting Committee 1987-1996; and various working groups (financial instruments, intangibles, public benefit entities) 1997 –2008.

I have been a member of the IFRS Advisory Council (2012-2014); IFRIC (2004-2008); and the Financial Instruments International Joint Working Group of Standard Setters (1998-2000). I am currently a member of the Academic Advisory Panel of the Australian Accounting Standards Board.

Prior to academia I spent over 10 years with a large international accounting firm, both in New Zealand and London. I have authored or co-authored over 100 academic and professional articles on issues relating to governance, auditing, financial reporting and financial analysis.

Comments on: Monitoring Group Consultation (Document): Strengthening the Governance and Oversight of the International Audit-related Standard-setting Boards in the Public Interest

Public Interest as a Pre-condition for the Proposals

The Monitoring Group's (MG) Consultation document (CD) states that 'public interest' is the overarching principle to the setting of standards. The document does not define 'public interest'. In fact the MGCD states that public interest is not a defined term as it evolves as public expectations change (page 9). Furthermore, the MG has asked the PIOB to support it in developing a public interest framework (page 9).

Without public interest being defined or a framework developed it is difficult to claim (as the MGCD does) that the "...standard -setters' understanding [presumably the IAASB's] of the public interest should be strengthened" (page 9) or that there is a "legitimate concern" over the "responsiveness to the public interest" (page 3). Furthermore, without a framework for public interest it is impossible to evaluate the proposed structures outlined in the MGCD.

That is, I agree with MGCD statement that: "...a public interest framework... serves as a mechanism for assessing how the public interest is captured" (page 9). Accordingly, my view is that the public interest framework logically precedes structural proposals. In my view the MGCD is premature. I am reluctant to make comments on how the proposals meet an unspecified public interest framework.

Public Interest as an Overarching Principle

I am not convinced that public interest should be **the** overarching principle. I agree that it is important principle, but other principles such as integrity, competence (credible) and objectivity (unbiased decision making) are equally important (see Taylor et al. 2003).

The ultimate objective of auditing standards is that they will result in the provision of reliable audit and assurance services. Public interest is satisfied if the audit and assurance services provided enhance the reliability of financial reporting. The focus should therefore be on developing standards that pave the way towards audit reliability, audit quality and financial reporting quality.

Public Interest as an End Point or a Process

The MGCD has conflicting views as to whether public interest is conceptualised as an identifiable end point or as a process (framework). For example consider the following:

- Page 4 states "...the views of those with the greatest concern about and commitment to the public interest". This is a curious statement. How can any one group claim to have the greatest knowledge of or the concern for or commitment to public interest? Especially when the term 'public interest' is vague and ambiguous (Dellaportas and Davenport 2008) or is open to debate with no universal agreement on what it means or how to measure it (Willmott 1990). Furthermore, the MGCD acknowledges there is no accepted definition of public interest.
- The MGCD, clearly envisages that the PIOB has superior judgement with regard to the 'public interest'. The PIOB is provided with the task of defining a public interest framework. It is also proposed that the PIOB has 'power of veto' over proper due process. By giving the PIOB the power of veto, the MGCD envisages that the PIOB is

judge and jury. In my view, the public interest is not an **objectively** identifiable end point; rather it is more tractable to think of it as the framework that surrounds ‘due process’. Allowing the PIOB to be the ‘monopolistic keeper’ of the meaning of public interest (an undefined term) and allowing this to over-ride due process is a very dangerous proposition. Considering public interest as a process suggests that factors such as board nomination, expertise, independence and transparency lead to proper due process. On what basis should anyone have veto over due process that has been properly established in the public interest?

Public Interest and Public Interest Entities

The focus of public interest in the MGCD implies the proposals focus on public interest entities (PIEs). However, the scope of most auditing and assurance boards go way beyond PIEs. For example, the XRB produces accounting and auditing and assurance standards for private (unlisted) for-profit entities, public sector entities and not-for-profit entities. Furthermore, ethical standards will typically apply to the accounting profession, not just to auditors. Thus a major issue for local standard-setters is the scalability of audit standards and procedures to smaller entities in term of cost-benefit.

It seems more palatable to provide assurance standards for smaller entities and then add-on additional considerations for PIEs, rather than to say “here are the standards for a quality audit” and then remove or modify PIE requirements for the audit of smaller entities. What this means, however, is that a framework for PIEs will not necessarily be acceptable to international standard setters that have to deal with smaller entities or emerging economies. For example, the IASB has the objective “to develop, in the public interest, *a single set* of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles” [my emphasis]. Yet the IASB has found it necessary to produce a suite of accounting standards for small and medium size entities. This has implications for the goal ‘to public acceptance and adoption in a broad range of jurisdictions over the long-term’ (Page 9).

Board Representation

To achieve ‘legitimacy’ the MGCD proposes “multi-stakeholder representation” (page 14), “geographic diversity” (page 14), equal representation from users, regulators and auditors (page 15). This approach can be described as ‘political representative legitimacy’; where legitimacy is achieved through the representation of interested parties. Political representatives are primarily chosen to represent their constituency, not because they are independent experts. A ‘political representative’ approach may also result in a Board that lacks the incentives to consider the costs of its standards on auditors and their clients (Kinney 2005).

An ‘independent expert’ approach would provide decision makers who (1) have expertise in the subject matter and (2) are required to be independent (financial or otherwise). Having a fulltime paid Board based on expertise would be my preferred option.

Need for the proposals?

The stated need for the proposals, in the MGCD, is based on the following:

- “questions have been raised about the independence of the standard-setting process”
- “questions have been raised about the ... responsiveness to the public interest”
- “legitimate concerns.. that the influence of the profession is at least perceived to be strong”
- [lack of] “... public confidence...”
- “[improvements] “...will encourage still-wider global adoption...”
- “... respond on a timely basis...”.

I think it is healthy to review organisations and structures from time to time to see if they are meeting their intended objectives or, indeed, to change those objectives and adopt new strategies. However, the proposal provides **no evidence** for any of the above claims. This is surprising, given that many standard setting organisations are currently adopting a more evidence-informed basis for decision making. Or, if the MG does have evidence, the proposal document is **not transparent**.

It is not obvious to me that the existing standards have failed to “...be well placed to secure acceptance and adoption in a board range of jurisdictions over the long-term” (page 9). Nor that the proposed structure will achieve this goal.

References

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Willmott, H. 1990. Serving the public interest? A critical analysis of a professional claim, in Cooper, D. J. and Hopper, T. M. (eds) *Critical Accounts*. London: Macmillan.