



Public Interest Oversight Board

*Overseeing international audit, ethics and education standards for the accounting profession*

7 February 2018

Mr. Gerben Everts  
Monitoring Group Chairman  
Dutch Authority for the Financial Markets (AFM)  
Vijzelgracht 50  
1017 HS, Amsterdam

Dear Gerben,

Thank you for the opportunity to submit the PIOB comments to the MG consultation process (CP).

The PIOB formulates its opinion based on its experience in overseeing standard setting, after a careful analysis of the consequences that the proposed changes may bring. The document attached reflects the outcome of a robust Board discussion on the proposals raised by the MG in the CP.

Please note that this opinion should be made available to the public after February 9, when it cannot influence the views of any other party. After that date, the PIOB will make this opinion available to the public.

The PIOB continues to support a constructive dialogue with the MG and other stakeholders, with the aim to build a standard setting system which is more respondent to the public interest.

Kind regards,

Eddy Wymeersch, PIOB Chairman



## **PIOB OPINION ON THE MG CONSULTATION PAPER February 7, 2018**

### **Introduction**

The PIOB is pleased to respond to the MG Consultation Paper dated November 9, 2017 (CP). The PIOB acknowledges that it is appropriate at this time, to review the standard setting process for auditing, ethics and education that was developed in 2005. The PIOB is pleased to see some concepts from its 2017 Strategy incorporated in the reform proposals.

The PIOB stresses the need for a broad, open and transparent consultation among major stakeholders to drive consensus and facilitate global adoption of international standards.

To underpin a successful reform outcome, the PIOB believes the MG needs to clearly set out the problem that it seeks to address. Unless this problem is clearly identified and articulated, it is uncertain whether the concerns expressed in the CP and the proposed structural reform will ultimately deliver an outcome which is proportionately better, from a public interest perspective, than the current structure.

Whilst the PIOB acknowledges that aspects of the current system are sub-optimal and that the undue influence by the profession on the audit and ethical standard setting system needs to be addressed, it is concerned that major changes to a reasonably well-functioning system exposes the global financial reporting system to substantial risks. The PIOB does not believe that there is a problem with the quality of the standards developed today.

The MG's CP raises twenty-seven questions within eight sections. The PIOB's response is organized by the eight sections presented in the CP.

### **Section 1 - Key areas of concern in the current standard setting model**

The PIOB agrees that the development of the standards can take a very long time under the present construct, and that this can have a negative impact on the relevance of eventual standards delivered. However, due process has sometimes required a long time to properly address different stakeholders' views or reformulate standards on the basis of those views. This is no different from accounting standard-setting. In addition, some important and relevant views (e.g., in the case of auditing standards, financial statement user views) fail to be conveyed, being outside the direct interest of the parties making comments on particular SSB projects.

## **Section 2 – Guiding principles**

Following a request from the MG, the PIOB has developed its Public Interest Framework (PIF), which includes the principles articulated in the MG CP. This PIF acknowledges that there is no universally agreed definition of the public interest concept. Nonetheless, useful criteria for an assessment of responsiveness to the public interest are set out in that PIF.

## **Section 3 – Options for reform of the standard setting boards**

The CP refers to two options in relation to a reformed standard-setting system. On the one hand, a single standard-setting board (SSB) would set audit, assurance and ethical standards for auditors, or on the other hand, two separate SSBs would continue, one for audit and assurance standards, and the other for ethical standards for all accountants.

Concentrating all standard setting activities in a single board potentially could have the advantage of having the International Standards on Auditing (ISAs) incorporating ethical requirements for auditors in an integrated and coherent manner. However, it could also result in ethical standards being marginalized with audit standards/requirements being prioritized and ethical standards being granted a secondary role. The PIOB believes that the concern being addressed in the CP is mainly one of coordination. This could be solved other than by merging the two boards. For example, a coordination committee between the two boards could identify special procedures to operate in cases of overlapping topics, planning meetings between the chairs could pre-empt substantially different approaches to common issues, the chairs of the two boards could attend each other's meetings, etc. The PIOB thus supports continuation of the two SSBs.

Respect for ethical responsibilities is crucial for promoting and maintaining accountant and auditor conduct that is within the boundaries of public interest. Audit failures result more often from unethical behavior, than from violation of auditing standards. Moreover, the political signal of abolishing the Ethics Board for accountants would be very negative. It would suggest that ethics is less important for auditors and accountants than regulations governing audit and accounting practice. The PIOB believes that ethical standards for auditors and accountants should be developed by one dedicated ethical standards board, and that a single set of ethical principles should apply to the accountancy profession as a whole. This does not preclude more stringent ethical requirements for auditors. Equally, the PIOB thinks that there must be a single set of audit standards applicable to all firms, listed and non-listed, developed by the same Board, whose applicability must be proportionate to the audited entity.

The PIOB attaches significant importance to the education of both practitioners and future generations of accountants. However, given the complexity of the education

environment and the lack of centralized authority to enforce adoption and implementation of global education standards, the PIOB believes that it would be relatively more effective if IFAC were to continue to lead education quality standards through its member bodies. The PIOB believes that its engagement with education quality standard initiatives has been, and would continue to be, constructive from a public interest perspective, even if a different development model to that used for auditing and ethics might be agreed among stakeholders.

The PIOB concluded in its PIF that adoption and robust enforcement of standards are critical elements of public interest responsiveness of professional standards. The PIOB also believes that advances have been made in this area by the Compliance Advisory Panel (CAP). It is desirable that IFAC continues its work in this area to strengthen its effectiveness in increasing adoption and compliance. The PIOB is concerned that the potential in terms of global adoption and implementation of auditing, ethics and education standards arising from collaborative support and oversight of CAP might be lost under the current MG proposals.

The PIOB believes that the members of the standard-setting boards should be full-time and remunerated. This is necessary to monitor the work of the staff of the standard setting board, made up primarily of members of the profession. As a consequence, technical advisor roles would become redundant and the boards by definition would adopt a more strategic focus.

With regard to majority voting, the PIOB's experience of the standard setting boards suggests this is not a major issue. However, if voting has to take place, a qualified majority of votes is preferable to a simple majority due to the global reach of the standards.

The PIOB supports a rationalization of the standard-setting boards, and believes that decision making is cumbersome in a structure with eighteen members and an equal number of technical advisors. However, it is difficult to quantify the optimum number. The PIOB's preference is that the standard-setting boards' membership should provide scope for desirable diversity. In addition to relevant expertise, Board members should be able to engage with, and provide leadership for, the standard-setting boards' agendas at a strategic level. They should be capable of operating in the public interest independently of any stakeholder group.

The PIOB believes that the Consultative Advisory Groups (CAGs) have played a very constructive role in the past. Their potential to contribute in the future is immense. However, their incentives and funding under the MG's proposals are unclear.

If Task Forces are to undertake detailed development work, they should adhere to the PIF.

## **Section 4 – Oversight/The Role of the PIOB**

The CP rests on the concept that the composition of the new multi-stakeholder SSB will itself naturally respond to the public interest. It proposes that the public interest will be embedded in the SSBs as a result of stakeholder representation in the boards' composition. The PIOB does not share this view. The PIOB believes that independent oversight would continue to be necessary to challenge biases (conscious and unconscious) that may limit the responsiveness of standards to the public interest.

The MG uses the IFRS-IASB model for standard setting in accounting as a reference for the reform proposals. It should be noted that standard setting in audit and ethics for accountants and auditors is different from standard setting for accounting and financial reporting in a number of important respects. First, in audit and ethics standard setting, engagement by stakeholders other than the profession (audit firms, PAOs and regional accountants' representative bodies) is very limited. Stakeholders other than audit firms rely on input from the profession to shape audit and ethics standards. In most cases, these stakeholders do not engage actively in consultation processes. Secondly, whilst accounting standards apply to the financial statements of companies, standards in the field of audit -both ISAs and ethics standards for auditors- guide the work of the auditor. Audit standards affect the rights and obligations of the audit profession directly, so the risk of pursuing professional self-interest in standard setting in the field of audit is higher than in accounting. A final difference is that the consequences of applying accounting standards are visible in the financial statements. However, how auditing standards are applied is, in effect, recorded in private audit files with only the final opinion visible to the category of stakeholders that typically does not engage in consultation (investors, analysts, other users). Compliance by accountants and auditors with ethics standards is even less visible to external stakeholders.

Therefore, contrary to accounting standard setting, oversight in the case of audit and ethics standard setting cannot just be an oversight of due process. There has to be a direct oversight to counterbalance intended and unintended bias, thereby reinforcing the public interest imperative. Public oversight in the case of audit and ethics standard setting cannot be just a technical confirmation of due process, as is the case with public oversight of accounting standard setting under the IFRS framework. While due process is essential for the public interest to be served in both cases, it is not sufficient in this case because audit and ethics standards are by nature different from accounting standards.

Thus, the PIOB believes it should continue to carry out independent oversight functions, including observations of SSBs' meetings. A proper resolution mechanism should be developed in cases where the PIOB's view differs substantially from that of an SSB. This mechanism should agree a timeline to articulate a solution.



Regarding the composition of the PIOB, the PIOB supports the notion of having a balanced worldwide composition to include members with substantial experience in regulatory and supervisory matters, in dealing with audit issues in practice, and who are familiar with concerns voiced by MG members and the profession, without being their representatives. Independence of PIOB members is an essential quality for effective oversight, and conflicts of interest have to be avoided. The presence of an independent (former) auditor or accountant in the PIOB does not necessarily give rise to a conflict of interest. Similar to the composition of the SSBs, a mix of expertise, relevant experience and perspectives is essential. All nominees should act in the public interest and independently of the stakeholder group of which they are a nominee.

Potential PIOB members should be identified through an open call for nominations from MG member organizations and other significant stakeholder groups. This process would lead to inclusion of a range of stakeholder backgrounds and desirable diversity.

In the context of the proposed reforms and the PIOB's response to those reforms, PIOB oversight should focus on auditing and ethical standards for accountants and auditors. For reasons already suggested in relation to challenges associated with regulating global education practice, education quality should continue to be driven by IFAC. In addition, education quality standards' development could benefit from PIOB engagement within a model that is different from the PIOB's role in audit and ethical standard-setting.

The PIOB 2017-2019 Strategy committed to make the public interest issues more transparent to the SSBs and stakeholders. This is a key improvement that should be part of the Reform.

With regard to the proposed role for the PIOB, there are some legal and practical problems linked.

Legally, it may not be possible for the current PIOB foundation to accommodate the new mandate, so one cannot exclude a scenario in which the current foundation may have to be liquidated and a new one set up to carry out the new mandate. This will depend on the extent of the impact of the reforms on the current PIOB mandate.

Regarding the proposed role for the PIOB to facilitate the collection of funds for the SSBs, the PIOB does not have the skills and the experience required.

Equally, regarding the proposed role in nominations to SSB positions, the PIOB may not have appropriate or sufficient networks to source the right people to fill these vacancies (skills, experience, diversity, gender, geography, etc.).



## **Section 5 – Role of the Monitoring Group**

The PIOB believes that the MG should continue to have overall responsibility for standard setting processes for audit and ethics for all accountants. To improve stakeholder understanding and engagement, the MG could improve its communications with stakeholders for the benefit of all participants.

The outcome of the current consultation may advise a review of the MG role and composition.

## **Section 6 – Standard-setting board's staff**

The PIOB supports the expansion of professional technical staff for SSBs. However, care needs to be taken to avoid over dependence on accountants and auditors. Close monitoring must be applied by the relevant SSB of full-time, remunerated members. The PIOB acknowledges the funding implications of a fully remunerated system. The PIOB also suggests that the agreed reform structure should be fully costed as soon as possible.

## **Section 7 – Process considerations**

The PIOB agrees with the proposed process improvements included in Section 7. It suggests that SSBs would also introduce impact assessments.

## **Section 8 – Funding**

Given the “public good” nature of audit standards, those who use the standards or benefit from them, in addition to organizations represented in the MG, should contribute to the funding. Stable funding is essential for the SSBs and any oversight body resulting from the reforms.

The PIOB believes that the introduction of a “contractual levy” on the profession mentioned in the CP could be a possible fruitful avenue to pursue, although it is unclear at this moment how this can be organized in practice. The independence risk of replacing IFAC funding with funding by major audit firms, should not be underestimated. This will most likely create a new perception problem.

## **Concluding comments**

The significance of high-quality audit and ethics standards for accountants and auditors cannot be overstated. They contribute to confidence in capital markets and to better accountability and governance in public and private organizations.



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The PIOB supports a review of the auditing, ethics, and education standard-setting process at this time. It welcomes engagement in this process by all stakeholders, and it believes that a more robust system can be built on the shared experiences of more than a decade of operating the current system. Any new standard-setting system must convince stakeholders that it will better support the public interest.

The deficiencies and limitations of the current standard setting model must be addressed in a way that does not expose the global financial system to substantial risks.

Finally, the PIOB believes that it would be useful to bring all relevant parties around the table after the finalization of this consultation to agree the way forward.