

## **Welcome**

### **Channa Wijesinghe**

- Participants were provided with an overview of how the sessions would be structured.
- Key concerns from the Australian and New Zealand jurisdictions were identified.
- Introduction of Mark Babington and his role in the MG process.

## **Current status of the MG Consultation Paper**

### **Mark Babington**

- Overview of the summary of the responses to the MG consultation paper provided a diverse range of responses.
- Acknowledged that it is difficult to go through this process, but the aim is for standards to be set in the public interest with high-quality adaptable standards applicable to all types of audits and assurance engagements.
- MG keen to get input from stakeholders hence the new round of roundtables. The focus of roundtables is to determine what is most important in the standard setting process and the priorities for what should be retained from the existing standards-setting process.

## **Preliminary Discussion**

- Attendees thanked MG for undertaking the consultation in Australia.
- The three Standard setting bodies are independent in Australia; Statutory Government bodies for accounting and auditing standards which provide the force of law; and separate Board for professional and ethical standards that cover the entire accounting profession. The Code of Ethics has the force of law for auditors.
- We are used to setting standards in the public interest. What are the concerns from MG's perspective?
  - IOSCO concerned about the whether the standards recognise investor protection and the role of investors.
  - Other organisations are concerned about financial stability and prudential regulation.
  - Some organisations think the standards are not in the public interest and point to examples of failures in process and the impacts on the quality of audits, such as:
    - a. Delay in revising ISA 600 relating to group engagements (took too long and there were known issues that needed resolution);
    - b. The finalisation process for the long association provisions (changes made at the last minute – were these in the public interest?); and
    - c. Going concern in auditor reporting (e.g. of a minister in the UK thinking about the auditor signing off on a 3-year going concern).
  - Issue not with the quality of the audit standards but how interpreted and applied.
  - Public interest means lots of different things to different people. The framework used by standard-setters should be transparent and make it clear that standards have been developed in the public interest.

- Consultation may be more efficient and timely if key stakeholders meet to discuss the proposals.
- IFAC funds all standard setting and currently 2/3rds of the PIOB costs. PIOB has not managed to be independent and obtain enough funding from sources other than IFAC. Forum of firms freezing funding to IFAC until governance system determined.
- The strong view that the problem with the current standard-setting model hasn't been articulated well and don't really believe undue influence by the profession has resulted in standards not being set in the public interest. The standards have acceptance in over 120 jurisdictions. Also queried how the recommendations will address the perceived problem we are trying to fix.
- The ISAs are viewed as a development tool by the World Bank and thus need to be given to all countries free or at minimal costs.
- View that the proposals are more for European based changes that are not reflective of views held in other jurisdictions. The current Standard Setting processes are not necessarily broken, but processes could be improved. This includes the need for continuous improvement processes being implemented.
  - MG has expressed a view that we need to get to an endpoint- cannot have perpetual evolution and reform. MG review is meant to happen every 5 years, but this has not happened historically in a timely manner. Questioned that if the regulatory community cannot fund the PIOB then is standard setting sustainable in the long term?
- The premise of issues with the public interest is not evident in Australia, and it would be useful for the evidence on this issue be disclosed to stakeholders.
  - Sorenson, an investor stakeholder, have stated that standards are more for the profession rather than those who rely on audits.
  - If investors are publicly involved in the process of developing the standards they cannot then complain about the results.
  - Query how would investors be able to be involved in standards like data analytics
  - Regulators become the de facto stakeholders who represent the public interest.
  - Kenneth Arrow (a Nobel prize winner) has stated that it is impossible to define public interest.
- It is hard to define public interest, and it is wider than just thinking about the users of the standards. It needs to consider a wide range of stakeholders. Audit serves a critical role in building public confidence and trust. A public interest framework is required to understand the proposals and how it applies to the standard-setting process.
- The strong view that ethics for accountants in business, accountants in public practice and auditors should be kept together and separate from audit board.
- PIOB and MG not transparent. MG promotes transparency and accountability but is hidden. Oversight is important but should be built into the process and should not have the power to veto standards.
  - MG created after the financial crisis. Group of authorities/regulators working together with the World Bank.
  - MG has received the message that they need to be more transparent.
  - Quasi-political figures in the MG Board that are different to the representatives at the MG level.
  - MG's power comes from the Charter & they have the authority to complete a review.
  - IFAC query whether the MG have the power to make the changes but are supportive of making the system better.
- Public interest outcome is high-quality audits.

- Standards aren't just for audits of public interest entities. They need to be adaptable to a range of assurance engagements and different types of entities. Owners of smaller businesses are getting over-serviced audits. Need to ensure the standards also cover performance reporting for public sector entities.
- Important not to overlook the National Standard Setters – they need to be included in the process. Their focus is on the standard setting process in the public interest and adoption of quality standards.
- Solving funding is problematic – investors most critical of the audit process but are reluctant to commit to funding a solution.
- Issues with the expectation gap with audits. The view that audits are 100% accurate; e.g., the current situation in the UK where audit failures are considered a major issue but actually audit failures are low. Not acknowledging that reasonable assurance is not the same as an absolute level of assurance.
  - IFIAR reports that problem is with the inconsistent application of standards;
  - Is there an accountability mechanism that needs to be implemented?
  - What lessons are being learned and are this reflected at the international level?
  - Australian attendees commented that cause of audit failure in Australia is the poor exercising of professional scepticism and judgement.
- UK law excludes practitioners from being in the standard-setting process. A differential level between the EU and rest of the world.
- What is the process of feeding back thoughts, and the development of the white paper? In relation to funding, how do the parts fit together – is it the structure that drives funding or figuring out what you can achieve with the funding you receive?
  - Working Group meeting on 11 July to develop strawman for the whitepaper.
  - Draft paper to be put to MG and they will, in turn, need to discuss with their own members
  - The white paper needs to set out a clear destination. Could set out what has to happen to get there or the most important issues to be addressed (so may not contain the detailed model)
  - Whitepaper should not set out to the nth degree how the Board should operate. They need to develop their own systems to remain fit for purpose.
  - MG has developed a strawman which considers different variables for the funding model.
  - Need parties (e.g., regulators) to make a long-term commitment to funding.
- Important to bring people along on the journey. The strong view that, if that impacts the timing of the whitepaper, then the white paper should be delayed ensuring consultation and stakeholder engagement occurs.
- Comparison of the IFAC commissioned Gibson Dunn report vs. the MG summary. They had different outcomes but looked at the same base data (apart from the one confidential submission from IOSCO). Standard setters will look at the due process & the transparency of the process.
  - MG not being transparent is a concern.
  - If stakeholders' views not being considered, then unlikely to get the necessary buy-in.
  - Transparency of PIOB is fundamental. PIOB should use the framework to ensure no surprise at the end of the process.
  - The question raised as to discrepancy of the representation of National Standards Setters in the MG report (8) compared to the Gibson and Dunn report (46). It was noted that the NSS Group of 46 represented a substantial proportion of the 180

Submissions. Mark noted that MG classified them depending on whether they were statutory standard setters.

- Some changes to occur in the governance process of the MG. Chair of the MG changes every two years. The election was held in May 2018. Wes Bricker (US SEC) was elected Vice-chair to December 2018. Wes will be co-chair from Dec 2018 to May 2019, when he will become the Chair.
- Detailed drafting at the Board level is not appealing to the public or to investors. Maybe the focus at the Board level needs to be more strategic and focussed on the outcome rather than the specifics of the wording.
- This will require increased resourcing of technical staff who do the detailed drafting with less involvement of the Board. However, the Board should have the requisite skills to review the work performed by the Technical Staff.
- The Standard Setting Boards, PIOB and MG should all adopt the Multi-stakeholder model.
- The IAASB and IESBA have CAG members (collectively 68) for input into the standard-setting process who represent different stakeholder groups.
- Is IFAC off the table? Does it have a role going forward?
  - MG comment – still an important role for IFAC around education. Some functions may remain with IFAC and some may not.

### **Key Points Raised in Table Discussions**

<b>Public Interest</b>
<b>Question 1</b>
<p>What are the key elements of a <b>framework for defining the public interest</b> and how can the Monitoring Group ensure that the public interest is properly represented throughout standard setting?</p>
<ul style="list-style-type: none"> <li>• Need to think about who can act in the public interest.</li> <li>• Public interest means different things to different people and may change over time and in reaction to specific events.</li> <li>• Is public interest about investor confidence or economic stability? It is broader than just investors or users of the financial reports, e.g., public, employees, government.</li> <li>• Public interest oversight should not include participation in the standards-setting process, so do not agree on the power of veto.</li> <li>• Public interest entities and auditors need to be very aware of who is using the information and the importance of reporting, not just financial reporting, and how we can contribute to building confidence and trust.</li> <li>• Discussion as to whether a framework which sets out a more transparent process would improve public confidence.</li> <li>• Are the changes being driven by the smallest portion of the profession (e.g., the tail wagging the dog?).</li> <li>• The composition of the PIOB should be representative of the multi-stakeholder approach.</li> </ul> <p>Key elements of a public interest framework:</p> <ul style="list-style-type: none"> <li>• Multi-stakeholder</li> <li>• Transparency</li> <li>• Clear due process</li> </ul>

- Open consultation process
- Transparent decision-making process.

### Question 2

Who (which stakeholder groups) **should standards be developed for**, and what should the priorities in developing standards be?

- Standard setting is not just about a high-quality audit.
- Compliance and enforcement have an additional impact on the content of standards.
- Ensure standards remain principles-based. Initially drafted this way, but then get convoluted as rules and regulations are incorporated to manage misbehaviour.
- Some standards are complex and not easy to understand, e.g., FRC ethical standards 2.3 d & 3.2d. When drafting standards need to consider who will use the standards.
- Auditing standards need to be developed for first and foremost for auditors, as a tool to achieve consistent, high-quality audits. They need to be workable, principles-based and to achieve reasonable assurance, not 100%. But acknowledgment that ultimately users and other stakeholders need confidence in the end product. Whilst regulators use them for enforcement, i.e., criteria, but not developed for them.
- Need to be cognisant of the purpose of the reporting, the assurance being given and what is important to stakeholders.
- IFIAR reports have noted the inconsistent application of the standards.
- Delays in drafting standards affect public confidence. Drafting might be better at a technical staff level.

### Question 3

How can **public accountability** of the board/s and the oversight body be best delivered?

- Public accountability should be embedded within the due process for setting standards. The oversight body should not have a right of veto.
- The work performed by the PIOB is not as open as the standard-setting boards. The PIOB should also be transparent in their processes and work program.
- The nomination process for the composition of the Board also needs to be more open and should consider the necessary or appropriate skills of board members.
- Some concern that “public” accountability implies only listed company shareholders. Auditing standards and Ethical standards are relevant to a much wider range of stakeholders.
- The criteria for public accountability needs to be established.
- Three key questions when considering accountability – for what, to whom, for what purpose?

For What?

- Auditing standards – for an opinion on financial statements (not for business models)
- Ethics – for public protection

To whom?

- Auditing standards – for users of financial statements
- Ethics – for wider public and stakeholders (regulators are not the proxy for this group, they are just one part of this group)

For what purpose?

- Auditing standards - so work is not self-serving, so there is transparency
- Ethics – trust in professional, acting without conflicts

- Oversight body for setting standards
  - along the lines of NED board
  - reporting that framework delivers due process
  - standard setting body is bringing in relevant competencies and is involving others.
- Those who have a real interest are not involved. If stakeholders are expressing concerns (European investor groups), they need to be part of the process, so there is real accountability. Need to be part of the formal process (part of governance and part of funding)
- Is empirical evidence needed to determine what we are trying to solve, i.e., what is wrong with the current systems in relation to public accountability?

## Roles, Coordination, and Engagement

### Question 4

For oversight:

- What do you consider the **role of the PIOB** should be (including any wider functions/responsibilities)?
- In particular, should the PIOB have a **requirement to confirm that a standard has been set in a way that meets the public interest?**
- What would the **multi-stakeholder concept look like at the level of the PIOB** and how should this be applied? How should the Monitoring Group maximise the opportunities offered?
- What are the **pros and cons of multi-stakeholder representation** at each level of the governance structure, and in aggregate?

- Any monitoring/oversight board does not need to have the words “public interest” in its name. All parties involved in the process will be acting in the public interest, not just that board.
- People on the monitoring/oversight board are appointed as individuals so are able to act in the public interest, they should not be conflicted/pressured by the position of their employing/nominating organisation.
- Role of the monitoring/oversight board should be to ensure that standards are set in the public interest. But if there is a public interest framework, there would not need to be an explicit statement to that effect, just that due process has been followed.
- Support for the multi-stakeholder concept, so long as no one sub-group could not block a vote (or vice-versa). So, if a 75% voting majority is required, there would need to be five sub-groups.
- Investors are not the only ones able to represent the public interest, so they should not be given any more weighting than any other stakeholder sub-groups.
- Multi-stakeholder would also have to be represented in other dimensions, e.g., geographically. The profession should also be represented on the PIOB.
- A skills matrix should be applied when appointing members to ensure diversification, but technical ability needs to be a prerequisite.
- There was a reference to the IASB governance model being a good example (IASB > IFRS Trustees > Monitoring Board) including the suggestion that we do not need both the PIOB and the Monitoring Group, just one monitoring/oversight board.

- Need to establish roles and responsibilities of boards first before determining structure (i.e., it might depend on whether standard setting boards take on a more strategic role).
- Need to separate fundraising activities, and governance of standard setting as fundraising takes up a lot of time and effort and could detract from governance if done by the same body.
- PIOB should consult on their strategy. [Note the PIOB do consult, but it falls below the radar – only received 28 responses to their last strategy and work plan consultation.]
- The PIOB deliberations need to be transparent, and its appointments should be via an open nomination process.

### Question 5

How should the work of the standard setting in audit and assurance and ethics **be better coordinated**?

- Coordination between ethics and standard-setting boards is essential – NOCLAR example of this
- Need to be **two boards** – one for ethics and one for auditing standards
- Some standards will require greater coordination – independence, professional scepticism, to ensure all on the same page as to what it means
- Coordination by:
  - Chairs talking
  - Strategies aligning
  - Joint or aligned working parties
  - Strategy Advisory Group
- Recognise that two models are emerging:
  - Separate board – Risk: workloads, overlapping, different meanings
  - One Board, two co-chairs, two deputy chairs – Risk: broader ethical matters lost in detail of auditing standards, considerations for professional accountants outside audit lost, lack of understanding about the difference between standards (directing work) and code (behavioural).
- The decision should not be made based on funding. Also, need to coordinate auditing with accounting standards setting.
- There is an inherent conflict of interest if the auditors set their own ethical standards.
- An alternative view is whether there should be any coordination between the boards at all. If auditors end up being involved in setting the ethical standards how sure would stakeholders be that the independence requirements are right? There would be a real conflict here.
- MG stated that there is some feedback from audit regulators that enforcement required more for ethical standards than auditing standards. Linking the standards might drive the uptake of ethical standards, e.g., Professional Scepticism.
- In NZ the ethical standards are bifurcated and looked after by two separate bodies. This has caused practical issues especially in relation to the timing of the implementation of ethical standards (e.g., NOCLAR). The Chair of the NZAuASB stated that they had experienced challenges in managing both.
- MG provided feedback that at the Singapore roundtable the focus was on the cost of the two boards. Initial calculation estimates differential of about \$4m USD
  - A strong view of Australian Stakeholders that cost should not be the driver of the fundamental issues. If seeking positive outcome of quality standards cost should not be the primary consideration.
  - Queried whether really a differential or just the cost of implementing other changes (e.g., remuneration for board members and covering the cost of all travel).

- Queried the level of cost savings as staff levels would have to remain the same and board meetings would need to be longer to cover both areas.
- Stakeholders of the view that ultimate aim should be the development of a quality set of global standards

### Question 6

How should a future board or boards engage with a wider range of stakeholders, including seeking input from stakeholders with a broad range of needs (for instance SMEs and emerging economies) in a multi-stakeholder model? How should that board/ boards be constituted?

- Is there a need for a large advisory council – based on the IASB model?
- Oversight body should include different stakeholder groups but would not be the same as the stakeholders on the board.
- The regulator shouldn't be on the board.
- Should not have a specific allocation for representatives from different stakeholder groups – may need to be more fluid – focus more on skill sets and qualifications
- MG presented a view that having fulltime Board Members mean they will have no outside interests/employment so no potential for conflicts of interest. This could limit the people willing to participate.
- Preparers of financial statements, people who are audited are not involved in the process – huge disconnect. They don't understand what drives the fees and the need for good standards.
- Audit fees are too low – people not valuing what an audit gives them.
- Stakeholder engagement with emerging economies important to ensure they are not having things forced on them that cannot be implemented.
- Engagement with a wider group of stakeholders with the use of technology.
- There is a view from some jurisdictions that if some of the Board members are full time that there will be more independence. Another view is that the full-time Board members may have more say in the development of standards compared to part-time Board members.

## Implementation

### Question 7

How should a **revised model be funded** to address any issues that may be perceived to impact on independence?

- Funding difficult.
- No single stakeholder group can dominate or be seen to dominate audit-related standard-setting by providing the majority of the funding, however, need to be willing to provide funding.
- Discussed a user-pays model similar to the recent approach adopted by ASIC. However, practical issues about how this would be implemented in each jurisdiction and could they maintain or monitor the collection of funds?
- Potential for the reformed oversight body to collect and administer the funding.
- Consideration of the IASB model and the establishment of the IFRS trustees.
- Consider the IASB model or similar. Each country who uses the ISA pays a percentage.

- If a levy was imposed would it consider the type of entity involved (i.e., PIE vs. other entity)
- Funding from stock exchanges or potential levy on audit firms.

### **Question 8**

**Should reforms be implemented incrementally**, or should all reforms be subject to a common implementation period? If incremental reform is the way forward, what should the priorities for reform be?

- Need to have an idea of the destination first
- Needs to be considered once proposals finalised. But importantly minimise disruption to the existing standard-setting process.
- Incremental implementation probably ok but depends on what changes are being made. Key decisions need to be decided first, then see if this determines a logical implementation process.