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Gemeinsame Stellungnahme von WPK und IDW im Rahmen der Konsultation der Monitoring Group zu IFAC-Reformen

Die Wirtschaftsprüferkammer und das Institut der Wirtschaftsprüfer in Deutschland e.V. haben in einem gemeinsamen Schreiben vom **13. August 2010** zu dem am 10. Juni 2010 veröffentlichten Konsultationspapier der Monitoring Group zu IFAC-Reformen wie nachfolgend wiedergegeben Stellung genommen.

Die Monitoring Group hat den Auftrag, die Wirksamkeit der im Jahr 2003 verabschiedeten IFAC-Strukturreformen zu beurteilen (Umsetzung und Erforderlichkeit weiterer Änderungen im Lichte der Finanzmarktkrise). Auf der Grundlage der eingehenden Stellungnahmen wird die Monitoring Group im November 2010 ihren Abschlussbericht veröffentlichen.

We would like to thank you for the opportunity to provide the Monitoring Group (MG) with our comments on its Consultation Paper of 10 June 2010 on the Review of the IFAC Reforms. Hereinafter, we will refer to the Consultation Paper as “the Paper”.

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 Wirtschaftsprüferkammer [Chamber of Public Accountants, Corporation under Public Law] (WPK) with its mandatory membership for the German audit profession operates under the public oversight of the Independent Auditor Oversight Commission (AOC) and the Federal Ministry of Economics and Technology (BMWi) and is, inter alia, in charge of the disciplinary oversight that encompasses the review of the compliance of WP with the aforementioned IDW Auditing Standards as well as with ethical and other professional standards. The IDW and the WPK are full and founding members of the International Federation of Accountants (IFAC). The IDW is also a full and founding member of the Fédération des Experts Comptables Européens (FEE). The WPK and the IDW have been joint sponsoring

organizations of members of the International Auditing and Assurance Standards Board (IAASB) and its predecessor, the International Auditing Practices Committee (IAPC), and of the International Ethics Board for Professional Accountants (IESBA), since their inception.

We believe that the IDW and the WPK are recognized by relevant Ministries of the German government and German regulatory authorities, and by the European Commission, as technically competent participants 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 Paper from this perspective.

While the Paper focuses on the IAASB and the IESBA, we recognize that the recommendations in the Paper will have an impact on other Public Interest Activity Committees (PIACs) of IFAC, and on the Consultative Advisory Groups (CAGs) and the Public Interest Oversight Board (PIOB). However, in our comments we will focus on the impact of the recommendations of the Paper on the IAASB, since this is the PIAC that concerns us most. Nevertheless, our comments may also apply to the other PIACs.

Before addressing some of the individual recommendations in the Paper, we will provide some general comments on the Paper.

General Comments

The nature of IAASB standards setting

At the end of page three, the MG makes the comment that its members are focused on the importance of high quality financial statement audits. While this is an appropriate focus, the MG should not lose sight of the fact that the IAASB is responsible for promulgating standards on assurance and related services in relation to subject matters beyond just auditing standards for audits of financial statements. The reasons for this are that there are subject matters beyond financial statements for which users in the market place seek assurance or other services, and that in some circumstances audits or reasonable assurance engagements do not represent the right cost-benefit balance for users.

As part of the standards setting process, users 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 standards setting in this area 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 standards setting, the quality and acceptability of the standards, and hence, whether they would meet the public interest, would be questionable.

Monitoring Group Approach to Conducting Effectiveness Review

We have a number of serious concerns about the approach taken by the MG to conducting the effectiveness review. The MG mentions drawing on the self-assessments from IFAC and from the PIOB, the discussions with them, the minutes of the PIOB, as well as the informal collection of thoughts from members of the CAGs and IFIAR. The MG then mentions the observations and experiences of its own members through membership in the CAGs, participation in roundtables and task forces, periodic attendance at board meetings and submission of comment letters. However, the fact that IFAC, the PIOB, the standards setting boards, and the CAGs were surprised by the content of the Paper suggests that the sources stated in the former sentence above were given less weight than that in the latter. It is hard to understand why the MG did not consult on early drafts of its Paper with IFAC, the PIOB, the CAGs and the standards setting boards to improve the evidential basis for its observations. In particular, the MG did not consult at all in a formal manner with the members and other participants (official observers and TAs) of the standards setting boards – and, in particular, not with the public members, who have a special role in safeguarding the public interest. The result was that in a number of instances, the observations in the report were based on rather thin evidence, and in a few cases, the assertions made are not borne out by the evidence.

For example, in the second sentence of the second paragraph on the fifth page the assertion is made that “...enhancements could be made to IFAC’s standards setting structures and processes ... to counteract some of the effects of the fact .. of auditor self-interest in setting such standards.” A similar assertion is made in the second paragraph of page twelve. No evidence demonstrating that standards had been issued with the effect of furthering auditor self interest is provided. Other examples of inaccuracies or a lack of evidence are provided in our comments to individual recommendations.

The first sentence of the first paragraph on the seventh page notes that “The Monitoring Group’s assessment does not judge the outcomes in terms of either the quality of the standards produced by the boards during the assessment period...”. In other words, in its assessment, the MG explicitly ignores the actual quality of the standards produced (i.e., the outcome of the standards setting process). Many of the views in the Paper appear to be based on the MG’s perception of potential weaknesses in standards setting governance and processes rather than upon specific examples pointing to inadequate standards. We are therefore concerned that by focusing only on perceptions in relation to the process, the approach of the review is too narrow and can be challenged as not dealing with the actual facts or the impact of the recommendations on standards setting out-

comes. In particular, the impact on the quality of standards of the nature and extent of expertise involved in the standards setting process appears to be underestimated.

In this context, the recommendations in relation to the issue of expertise do intimate a discomfort with the participation of the profession in the standards setting process. It is not clear from the Paper what the ultimate objectives underlying the recommendations 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 standards setting is critical to ensuring that standards are set in the public interest rather than in the sole interest of those that are applying them, but further increasing the proportion of such stakeholders such that they actually constitute a greater preponderance of members in standards setting boards may lead to the degeneration of technical standards setting boards into political bodies that know very little about the details of what they are regulating. The key question that the MG needs to consider is what its objectives actually are, to state these clearly, and to fashion its recommendations to meet those objectives based on the facts and in cognizance of the impact of those recommendations on the quality of the standards set.

In relation to the approach of the MG, item (iii) on page seven (and item (iii) on page eight), includes a comparison of the original reforms with “features that the Monitoring Group believe have today come to be associated with credible international standard-setting processes”. It is unclear to us what the benchmark for such features are and from where the MG would draw examples of credible *international* standard setting processes superior to those currently in effect for PIACs at IFAC. Furthermore, item (iv) thereafter (and item (iv) on page eight) encompasses in the assessment new factors in the global capital markets that may warrant a future review of the overall standards setting governance, structure, and arrangements. The Paper does not appear to identify any such factors and therefore it is unclear to us why on this basis a future review of standards setting governance etc. is needed.

From our point of view, the MG’s assertion in item (ii) on page eight of the Paper that its recommendations represent “fine tuning and adjustment” underestimates the potential impact of its recommendations on the quality of the standards set and on the structure of standards setting boards of IFAC under the IFAC Constitution.

Assessment of the Implementation of the Reforms

We are pleased that the MG has come to the conclusion, with which we concur, that IFAC has implemented virtually all of the reforms set forth in 2003. However, we are concerned about the conclusion in this respect made in the last paragraph of page nine that "... the manner of implementation of some of the Reforms has not completely achieved their aim."

The claim that the implementation of the reforms has not completely achieved their aim suggests that there is a clear aim or objective that the reforms were seeking to achieve. It is not clear from the Paper what this objective might be. Without having clearly described the objective and providing evidence of the basis for the assertion that such objective has not been completely achieved, it is difficult for readers to understand the basis for the observations and recommendations that follow. As noted above, there does seem to be an implicit "objective" underlying the observations and recommendations in relation to the further reduction of the influence of the profession and its expertise in standards setting. However, the appropriateness of this objective in relation to the objective of high quality standards is not explored.

Comments on Selected Recommendations

Composition of the Standard-Setting Boards

Recommendation 1: The Monitoring Group recommends that IFAC appoint a mix of Audit Board and Ethics Board members appropriate to the need for both technical competence and objectivity in the work of each respective Board such that there is parity — or perhaps even a majority — of Board members with professional career experience that substantively goes beyond that of an auditor.

As we note above, there are important issues in relation to the overall objectives of standards setting that mitigate against increasing the preponderance of non-practitioners on the standards setting boards. In practice, however, the number of those with backgrounds outside of audit is already substantial, and in some cases represents a majority. The MG needs to recognize that increased "objectivity" may be purchased at the price of "technical competency", without which high quality technical standards cannot be written.

For these reasons, we would not support a general requirement that causes a further decline in the number of practitioners on the board.

Assignment of Board Seats

Recommendation 2: The Monitoring Group recommends that IFAC discontinue the practice of reserving a specific allocation of Audit Board and Ethics Board seats for a particular type of background—in this case for FOF nominees—and instead consider FOF nominees among all the candidates it evaluates in deciding upon the optimal mix of Board members based upon all the relevant dimensions of balance and diversity.

The Paper states that board members from the FOF members bring “helpful” expertise to the respective boards’ work, and as such are to be expected to continue to be interested in becoming and make desirable board members. We would contend that the practitioners in general, and from the FOF in particular, provide the expertise necessary for the IAASB and the IESBA to set high quality auditing and ethics standards at all. The tone and substance of the recommendation indicates that the MG may be underestimating the importance of technical expertise in standards setting. For these reasons, we would not support changing the current allocation of seats for the FOF.

Ability to Attract Public Board Members

Recommendation 3: The Monitoring Group recommends that IFAC explore financial measures, such as reasonable stipends if they would not raise questions about independence and objectivity, to accompany travel cost reimbursement for Board members who are public members that are employed by an organization that cannot provide financial support of their participation as a Board member.

The question of “reasonable stipends” for public members needs to be addressed from the financing angle. It appears that the underlying problem is the unwillingness of other stakeholder organizations (associations of preparers such as industry associations, and associations of analysts, etc.) to bear the cost of sponsoring a member on the boards. The fact that such groups are prepared to take part in the CAG meetings, but not bear the cost of having a member attend IAASB meetings, is indicative of the fact that these groups have little technical interest in auditing standards setting, but do have great political interest in the overall outcome of auditing standards setting. Having IFAC pay stipends for public members would encourage a “free rider” syndrome among these other stakeholder bodies that would need to be borne by the profession, which would be unfair in principle. Rather, IFAC and the MG need to encourage these other groups to recognize the importance of audit standards setting by having them bear the cost of members that they sponsor. If, despite the endeavors by IFAC, the PIOB and the MG, stakeholder organizations other than from the profession are not prepared to bear the cost of sponsoring members, then the MG will need to draw the conclusion that these other stakeholders must believe that, irrespective of any assertions on their part to the contrary, the technical details of auditing standards setting is not of enough interest to them.

Operating Procedures of the Standard-Setting Boards

Recommendation 5: The Monitoring Group recommends that IFAC change the manner in which expert technical information and support is made available to the Boards. This would make it clearer that the Board members themselves, and not the Technical Advisors, are the principals in the Board’s discussions, deliberations and decision making.

Since this issue was first raised by MG members in the development of this Paper, the Chairs of all the PIACs have emphasized in their opening remarks the respective roles of members and technical advisors. Technical advisors are held to not knowingly express

views at board meetings that are at variance with those of their member and may speak only with the permission of their member and when recognized by the chair of the board. This seems to have worked well in reminding all participants of their respective roles.

The Paper suggests that “often technical advisors are employed in the audit profession, most typically by the larger audit firms”. In fact there are only nine technical advisors supporting the Audit Board members, four supporting the Ethics Board members and five supporting the Education Board members who come from larger audit firms. Many technical advisors not from the firms are from national standards setting bodies and are professional standards setters who bring needed technical expertise and standards setting skills to the boards. We therefore find the assumption stated in the paper to be inappropriate.

Board members themselves see an overwhelming benefit from the participation of technical advisors. On occasion when permitted by their member and the chair, technical advisors point out technical issues or inconsistencies in wording that board members may have overlooked in debating the content of a standard.

We believe that in the context of technical standards setting boards, the current role for technical advisors is appropriate to help ensure the issuance of high quality standards. To clarify that role, we would agree to a requirement that the Nominating Committee vet the qualifications of proposed technical advisors.

Recommendation 10: The Monitoring Group recommends that IFAC put in place the arrangements for the Boards to provide feedback to individual Monitoring Group members regarding a member’s input to the Boards if it does not appear that the Boards will take up the input in a final Standard in the manner that the Monitoring Group member recommended.

It would impair the independence of standards setting boards in both appearance and fact and hence detract from the credibility of the standards setting process if some stakeholders were given special treatment in the responses of those boards to comments. 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.

Other Issues

Page four of the Consultation Paper indicates that the MG will initiate a future effectiveness review approximately three years after its completion of this one unless circumstances indicate that an earlier review is considered necessary.

We support the need for all organizations to undergo independent review of their activities and processes. However, changes to critical elements of the global financial reporting

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supply chain must be made gradually if the integral process is not to be weakened in the process of introducing the changes, and the results of transparent standard setting cannot be assessed until one or two years of application of new or improved standards.

We believe that a commitment to perform another review within three years is too soon. We strongly recommend that the review should be planned for five years after the completion of this current one, but always with the provision that the MG can call for an earlier review if circumstances warrant it.