ACCOUNTANCY EUROPE.

STANDARD SETTING IN THE 21ST CENTURY

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COGITO.

Cogito: I think
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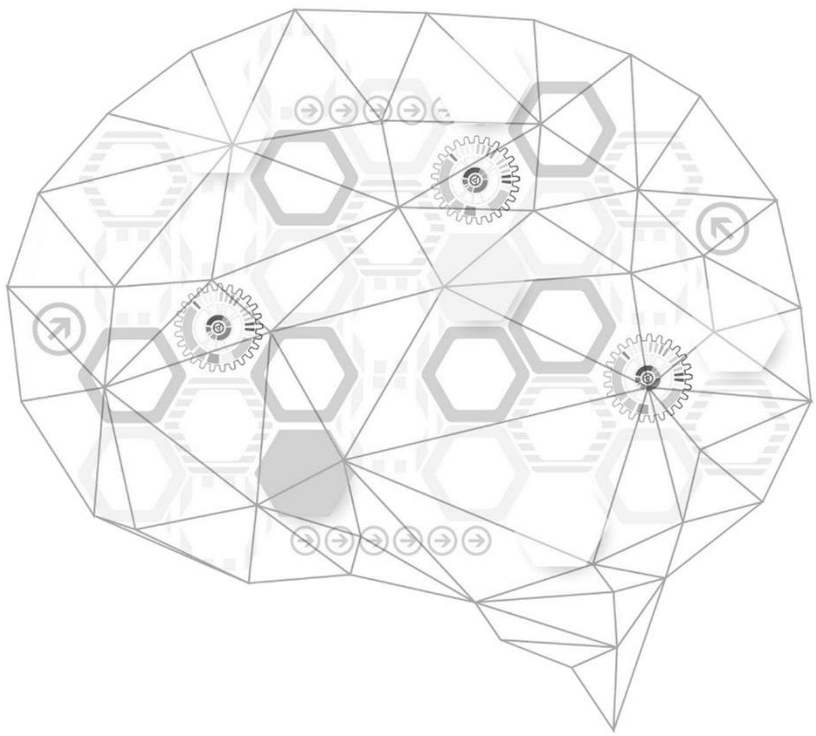

COGITO

This document is part of the *Cogito* series, a selection of thought-provoking publications by Accountancy Europe.

Cogito (i.e. I think) is set up to provide new ideas for the European accountancy profession. With this series, we aim to enhance innovation and our contribution to business and society.

This publication aims to stimulate debate; the views expressed thus do not reflect the official positions of Accountancy Europe or any of its 50 member bodies.

HIGHLIGHTS

Accountancy Europe takes a thorough look at how standard setting for financial reporting and auditing is organised now, and what could be improved to keep this process relevant for the needs of the 21st century.

Technology and globalisation of business and the accountancy profession have changed what stakeholders expect of standard setting. Some think todays' process is too complicated, moves too slowly and they raise questions on its legitimacy.

We propose the principles and criteria that standard setters should embrace and suggestions for improvement where current standard setters do not meet these criteria. We provide ideas, but encourage feedback on this paper as only collective discussion can provide solutions for the future of standard setting.

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EXECUTIVE SUMMARY

Considerable changes have taken place in society in recent times, including changes driven by technology or changes stemming from the aftermath of the financial crisis. Therefore, there has not only been considerable debate related to requirements set in law in recent years, but also with regards to the frameworks and standard setters in financial reporting and auditing. This paper seeks to explore how the 21st century standard setting should look in order to ensure standards' relevance to the market's and stakeholders' evolving needs.

The scope of the paper is restricted to global standards under public oversight which cover accounting and financial reporting (private and public sectors), auditing (including internal quality control), and ethics including the independence of practitioners performing assurance engagements.

In an effort to understand how the future of standard setting is evolving, this paper looks back into the origins of standards as a product as well as the purposes of standard setting and standard setters themselves (section 1). The various available definitions of standards as well as their desired characteristics can help us understand how the final product would look and how it would serve the needs of relevant stakeholders. Some of the characteristics considered essential for standards are: being effective, principle-based, implementable, responsive and practical, but also technically sound (subsection 1.1).

It is also crucial to consider how standard setting is structured and standard setters work (subsection 1.2). Most importantly it is key to set out clear objectives and principles for the standards from the very beginning (while preparing the standards): what is the change that they should bring about? Despite the undoubted need for consistency, standards should not be applied in a tick-the-box fashion but rather in a principle-based manner. Standard setters need to facilitate the smooth operation of the standard setting process. As part of their mission, they need to engage with relevant stakeholders to understand their views and potential concerns with an existing or a proposed standard.

Engaging with stakeholders and serving the public interest are priorities in standard setting today and are addressed in section 2. Standards are developed to increase trust and serve the market's needs. However, as the audience of standard setting has grown massively, interaction with stakeholders seems to have turned into a daunting task for standard setters. In addition, standard setters are expected to find the right balance between stakeholders' expectations and the objectives of the standard setter, especially when it comes to serving the public interest. To make this happen, standard setters need to listen to comments coming from all sides and make sure they strike the right balance between this feedback and serving the public interest.

This publication aims at stimulating debate. To this purpose, section 3 includes a number of proposals on i) the principles and criteria that standard setting in the 21st century could embrace (subsection 3.2), and ii) how existing standard setters could get closer to these 'ideal' principles and criteria (subsection 3.4). The proposed principles of modern standard setting include the following:

A. legitimacy: a legitimate standard setting process means that standards can sufficiently serve their purpose, within the terms of reference of the standard setter

B. independence: independence in standard setting should permit the issuance of standards without them being affected by any undue influences or conflicts of interest that could compromise them

C. transparency: transparency enhances stakeholders' trust in the standard setter's decision-making process

D. public accountability: public accountability means ensuring that standard setters take responsibility for their actions and are ready to redress issues if appropriate

E. due process: due process should also ensure that the development of the standards is accountable and transparent and contributes to enhance the standards' legitimacy

F. balanced membership: board members should come from diverse, but relevant, backgrounds in order to be able to gain more acceptability and diversity of input into the standard setting process

Each of these principles is further explained and analysed in subsection 3.2 by proposing criteria on how to reach these principles.

Some of these proposed principles are currently met by the existing standard setters. These are not further mentioned in subsection 3.4. For those on which standard setters seem to lag behind, we have identified the issues in subsection 3.2 and included in subsection 3.4 some suggestions for the areas that we consider as needing improvement. Some of these issues and suggestions are highlighted below:

A. Legitimacy: When it comes to timeliness and innovation all existing standard setters (IAASB, IESBA, IASB, IPSASB) would need to improve their practices both regarding including technology in their working plan but also regarding timely issuance of standards, i.e. responding to the market's current needs. Some of the proposed ways to improve timeliness is to further assign tasks to specific board members – being more flexible – and assign more tasks to the boards' secretariat, allowing for the boards to work on strategic topics.

B. Independence: When considering board composition and a balanced and sustainable funding model, boards supported by IFAC need to safeguard an independent board overall, increase transparency in nomination as well as ensure neutral sources of funding.

E Due process: Public oversight bodies have a crucial role in approving the due process is being followed. Looking into the existing oversight bodies the following suggestions for improvement are made:

  - The PIOB's mandate should be reconsidered. The PIOB should oversee – not perform – the standard setting due process and board nominations taking into account the public interest. The PIOB should also improve its communication practices.
  - A consideration for all standard setters should be to have only one public oversight body with clear objectives.

F Balanced membership: Regarding the board nomination process, all boards supported by IFAC need to ensure transparency on the selection criteria and process. In addition, the secretariats of the boards need to attract more senior staff, gain stronger ownership, and become less procedural.

Reaching final conclusions in this paper is a challenging task. In fact, the intention of this paper is to raise ideas which can only be answered though collective discussion and diverse views, paving the way to change and future-proof solutions. Times have changed since standard setting was introduced to the market. There is an urgent need to re-open the debate on standard setting to prepare it for the 21st century. Discussions on the future of standard setting should be inclusive and open to change and challenge.

Accountancy Europe would like to invite readers – including corporates, politicians, regulators, investors, NGOs, accountants, and other stakeholders – to participate in our efforts to identify the dynamics for change and contribute to shaping the future of standard setting. We welcome any input and comments to this paper. Please send your comments to Hilde Blomme or Eleni Kanelli via email: hilde@accountancyeurope.eu or elenik@accountancyeurope.eu.

FOREWORD

Considerable changes have taken place in society in recent times. Many of these have been driven by advances in technology, such as the massive availability of data and speed of information exchange. Other changes have stemmed from the aftermath of the financial crisis, which gave way to increased scrutiny having a major impact on business and supporting professional services. In addition, all these and other trends have changed the expectations of diverse stakeholders.

Professional accountants play a key role in business. Many are involved in an entity's corporate reporting function, preparing its financial statements. Likewise, professional accountants in accountancy and auditing provide assurance services, such as audit, to give greater credibility to certain information, including the annual financial statements.

The frameworks for financial reporting and auditing, in addition to requirements set in law, are established via the setting of standards for financial reporting and auditing.

These standards play a key role on deciding:

- what, how, where and when information is included in financial statements
- what assurance conclusions are provided on financial statements and by whom
- how the exercise of professional judgement and compliance interact

The need for standards was driven by the reaction to the Great Depression in the United States of America (US) in the late 1920s when poor accounting and reporting was seen as being complicit in the factors which led to the downturn. Similarly, in other countries and at different times, standards were introduced:

- following accounting scandals to counteract certain accounting treatments which had led to accusations of misleading financial statements
- to harmonise accounting practices in circumstances where different treatments were being adopted for fairly common transactions

Standards in both accounting and subsequently auditing were therefore initially introduced at the national level to help facilitate the spread of best practice and to help promote greater conformity within a specific jurisdiction. Initially, the approach to the setting of standards was left to the accountancy profession itself. Over time there have been increasing discussions about whether the norm for standards of especially listed and public interest entities (PIEs) ought to be set by standards setters deemed to be independent of the accountancy profession and other stakeholders. This is evidenced by the US accounting standard setting process, which for many years fell under the responsibility of the US professional accountancy body. This changed with the establishment of an independent standard setting board, the Financial Accounting Standards Board (FASB), which was set up under the auspices of the Financial Accounting Foundation in the early 1970s.

Standard setting had to evolve to meet the demands of the increased globalisation of business, the investment community and the accountancy profession. This led to the development of international standards in accounting and in auditing. Relevant to these developments, but particularly with regard to assurance, was the need for global ethics requirements for professional accountants. Over the years, in each of these areas, different models for standard setting at global level have evolved. Currently, the four independent standard setting boards with responsibility for auditing and assurance, education, ethics, and public sector accounting are still largely resourced by the International Federation of Accountants (IFAC) whilst the International Accounting Standards Board (IASB) that sets the financial reporting and accounting standards for private sector entities is resourced and governed by the International Financial Reporting Standards (IFRS) Foundation, sourcing its budget primarily from industry and the profession.

There has been considerable debate in recent years with regards to the standard setters in accounting and auditing. This paper seeks to assess what type of standard setting body is required for standard setting in the 21st century.

The scope of the paper is restricted to global standards under public oversight which cover accounting (private and public sectors), auditing (including internal quality control) and ethics including the independence of practitioners performing assurance engagements. Accounting standards (public and private sectors) may be applied by individuals who are not professional accountants and are likely to be of interest to a wide group of stakeholders. Nevertheless, in many jurisdictions, those applying accounting standards in the public and private sector are often professional accountants in industry. Auditing standards are applied only by practitioners (including firms) that perform audits, and standards on internal quality control are applied only by accountancy firms that perform assurance (including audit) and related services – i.e. a more specialised group of users.

The purpose of this paper is to put the finger on the pulse of modern standard setting and stimulate the debate amongst the different parties on how to keep standards future-oriented.

1. BACKGROUND

1.1 WHAT IS A STANDARD?

DEFINITION OF STANDARDS

The Oxford English dictionary definition of the word ‘standard’ includes the following:

> *“A level of quality or attainment. […]” (Oxford dictionaries)*[1]
>
> *“Something used as a measure, norm, or model in comparative evaluations.” (Oxford dictionaries)*[2]
>
> *“(standards) Principles of conduct informed by notions of honour and decency.” (Oxford dictionaries)*[3]

A review of other literature reveals several similar definitions. The consensus, therefore, is that a standard is a means of establishing a minimum benchmark of quality whilst also achieving a certain level of harmonisation. Building on these dictionary definitions, various bodies have provided their own definition of what a standard is for their respective purposes:

[1] *standard*. (n.d.) In: Oxford Dictionaries [online] Available at: https://en.oxforddictionaries.com/definition/standard.
[2] ibid.
[3] ibid.

> *"[A standard is a] written definition, limit, or rule, approved and monitored for compliance by an authoritative agency or professional or recognized body as a minimum acceptable benchmark." (BusinessDictionary)*[4]
>
> *"A standard is a common set of characteristics of a particular good or service." (OECD)*[5]
>
> *"[A standard is] a common language which defines quality and safety criteria." (Standards Australia)*[6]
>
> *"[Standards are] technical specifications contained in a document that lays characteristics of a product such as levels of quality, performance, safety, or dimensions. Standards may include or deal exclusively with terminology, symbols, testing and methods, packaging, or labelling requirements as they apply to a product." (WTO)*[7]

The Organisation for Economic Co-operation and Development (OECD) provides specialised definitions for standards by grouping them in categories based on their purpose[8]. One of these categories is on 'professional conduct and certification standards'.

> *"Professional conduct and certification standards define the performance of professions. Conduct standards may include ethical standards or rules on advertising. Certification standards may include criteria that must be met by professionals performing certain actions. These standards can convey valuable information about the training and competences of professionals." (OECD)*[9]

According to the OECD, professional conduct and certification standards may include criteria for proposed benchmarks for the profession's activities as well as ethical standards. This definition seems to be one of the most suitable for use by services' professions particularly when it comes to the wide use of professional judgement to apply these standards. Likewise, the essence of many of the definitions listed above is that a standard is used to denote quality. This applies in the accountancy profession where IFRS and International Standards on Auditing (ISAs) are seen as the global benchmark of quality in their respective disciplines.

OBJECTIVES OF STANDARDS

In light of the above, it is necessary to specify the objectives of those standards which are of relevance to the profession. As stated in the introduction, this paper considers the following international standards covering accounting, auditing, ethics and independence as well as internal quality control (Figure 1):

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[4] *standards*. (n.d.) In: BusinessDictionary [online] Available at: http://www.businessdictionary.com/definition/standards.html.
[5] Organisation for Economic Co-operation and Development (OECD), (2011). *OECD Policy Roundtables Standards Setting 2010* [online] Available at: http://www.oecd.org/daf/competition/47381304.pdf.
[6] Standards Australia. *What is a Standard?* [online] Available at: http://www.standards.org.au/standardsdevelopment/what_is_a_standard/pages/default.aspx.
[7] World Trade Organization (WTO), (1986). *General Agreement on Tariffs and Trade* [online] Available at: https://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf.
[8] Organisation for Economic Co-operation and Development (OECD), (2011). *OECD Policy Roundtables Standards Setting 2010* [online] Available at: http://www.oecd.org/daf/competition/47381304.pdf.
[9] Ibid.

Type of Standards	Applicable Sector	Standard setter
International Financial Reporting Standards (IFRS)	Private Sector Accounting (Adapted for use in the Public Sector in some cases)	International Accounting Standards Board (IASB)
International Standards on Auditing (ISAs) and other assurance and related services standards[10]	Private Sector Auditing (adapted for Public Sector Audits in some cases); private sector assurance and related services standards (also applied in some Public-Sector Assurance and related services)	International Auditing and Assurance Standards Board (IAASB)
International Standards on Quality Control (ISQC)	Private Sector Assurance (including auditing) and related services (Adapted for the Public Sector in some cases)	International Auditing and Assurance Standards Board (IAASB)
Ethics and Independence	Private Sector (Adapted for the Public Sector in some cases)	International Ethics Standards Board for Accountants (IESBA)
International Public Sector Accounting Standards (IPSAS)	Public Sector Accounting	International Public Sector Accounting Standards Board (IPSASB)

Figure 1: International Standards relevant for the Profession

As indicated, standards may embed different purposes depending on the agreed needs. Overall, one could summarize the objective of standards as follows:

> *"[To] provide specifications, [requirements, guidelines or characteristics] and procedures designed to ensure that products, services and systems are safe, reliable and consistently perform the way they were intended to." (Standards Australia)*[11]

In order to become more specific and relevant to the profession, there is a need to consider the historical evolution of accounting, financial reporting, assurance, ethical and independence standards in the private sector as well as public sector accounting standards. As indicated in the previous section, relevant standards were developed – among other reasons – because of the need for the profession to perform better and more consistently, providing the market with better services. Accordingly, one can claim that two of the key purposes of standards would be to:

- "promote better operation/functioning of markets" (OECD)[12], including working towards setting specific benchmarks
- achieve a set level of quality by requiring the performance of services to a specified norm

Achieving quality is key to standards relevant to the profession. When developed, standards themselves should contain principles aimed at instigating high quality performance of services.

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[10] Apart from ISAs, the IAASB also issues International Standards on Review Engagements (ISREs), International Standards on Assurance Engagements (ISAEs) and International Standards on Related Services (ISREs). These other assurance and related services standards will not be further considered in this paper.
[11] Standards Australia. *What is a Standard?* [online] Available at: http://www.standards.org.au/standardsdevelopment/what_is_a_standard/pages/default.aspx.
[12] Organisation for Economic Co-operation and Development (OECD), (2011). *OECD Policy Roundtables Standards Setting 2010* [online] Available at: http://www.oecd.org/daf/competition/47381304.pdf.

EXAMPLE

A set of financial statements prepared under IFRS provides an informed user with a clear message that they have been prepared under a globally accepted accounting framework. IFRS has very much become the global language of accounting especially in relation to listed entities. An accepted business language of this nature also provides a means by which those charged with running a business can be held accountable for their performance.

Overall, the use of standards has played a leading role in creating a more harmonised market for the profession. By requiring consistent performance from those who comply with them, standards can improve the quality of services and help to promote a level playing field among professionals.

Nevertheless, in order to see these and other benefits resulting from the use of standards, there are certain characteristics and principles that standards need to have when applied. Although not exhaustive, the following section attempts to indicate certain key characteristics that needs to be identified in standards.

CHARACTERISTICS OF STANDARDS

Given that the OECD has identified five wide-ranging categories of standards, it is unlikely that a common set of characteristics can be universally applied to all standards. The nature of the subject-matter varies, as well as the interests of the stakeholder groups. There may also be differences in relation to standards applied on products and services ('technical') versus standards intended to standardise behaviour.

Nevertheless, there are certain essential characteristics that need to be present in a standard in order for it to meet the objectives of stakeholders. Listed below are some of the key characteristics that are identified as key for standards applied by the profession. This list is not exhaustive and none of the characteristics listed below should be considered as having primacy over the others. On the contrary, standards should combine all of these characteristics in a balanced way. Ultimately, what is essential is that standards should be fit for purpose.

Elements that contribute to achieving these characteristics are:

EFFECTIVE & PRINCIPLE-BASED

- Standards should be responsive to market's needs and issued on a timely basis.
- Standards should be prepared to an acceptable level of quality that allows them to be implemented in a consistent manner.
- Standards should be proportionate to their objective. To be applied efficiently, standards need to give a balanced framework of requirements and guidance without going into unnecessary details and overburdening the text.
- In the same spirit, standards should be expressed in a principle-based manner and allow for those applying them to reasonably use their judgement.

PRACTICAL & IMPLEMENTABLE

- Standards are established to provide a solution to emerging and practice problems. Such problems include for instance evolutions in the stakeholders' demands or changes in the market environment.
- The standard's purpose should be clear and should be written in an understandable manner as much as possible.
- Standards must be capable of being applied in practice and scalable to size and complexity. Standards should be as simple as possible to implement.
- The perceived benefits to stakeholders as a whole of introducing a standard should outweigh the associated costs to those stakeholders as a whole (qualitative as well as quantitative benefits and costs need to be considered in this assessment).

RESPONSIVE & STABLE

- In order to ensure proper implementation and continuing relevance, standards need to respond to the actual market's needs as well as to evolving practices and innovation. Standards should be designed to adapt to changes and should be reviewed from time to time, when there is sufficient evidence of evolution in technology, knowledge and community[13].
- At the same time, standards need to be stable. Even though standards need to be reviewed and adapted, standards' stakeholders need to rely on a stable framework that will support long term goals such as promoting better operation of markets.

TECHNICALLY SOUND

In combination with the above features, standards should reflect appropriate technical expertise. At the end of the day, standards are meant for application by experts and there would be no point in using them should they lack technical robustness.

GLOBAL APPLICATION

Standards can be applied at several levels: regional, national or global. In this paper, interest is concentrated on the global level. Therefore, one of the characteristics to take into account would also be consistent application on a worldwide basis.

Besides defining the characteristics of standards, it is fundamental for the standard setting process to set standards meeting the above-mentioned characteristics. This is the process which provides shape to the standards (as developed below in subsection 1.2 What is standard setting). Some of the elements to be included in the standard setting process are: (i) clear definition and agreement of the objectives of revising or issuing a standard, (ii) quality control that checks whether the objectives initially set have been met; and (iii) a post implementation review verifying that standards have not raised unintended consequences. These elements are further explained in the sections below.

SOME OTHER CONSIDERATIONS[14]

When looking into the standards and their features, there are additional factors that – although not part of their characteristics – influence the development of standards as products as well as the way they are perceived and applied. Some of the key ones would be:

INTERACTION WITH LAW & REGULATION

The interaction of standards with law varies across sectors and countries. There are cases in which standards have been enacted into legislation and thus became mandatory. In other cases, standards are enforceable by regulators while there are also cases where standards are only professional standards or even entirely voluntary tools.

EXAMPLE

The application of IFRS around the globe highlights different approaches which have been taken in this respect. For example, the European Union requires that before an IFRS becomes applicable, it must first be approved via an endorsement mechanism. This has resulted in IFRS as adopted by the EU not being exactly equivalent to IFRS as issued by the IASB. Additionally, there are other standards recently issued by the IASB which have still to receive EU endorsement.

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[13] Standards Australia. *What is a Standard?* [online] Available at: http://www.standards.org.au/standardsdevelopment/what_is_a_standard/pages/default.aspx.

[14] Although plenty of other considerations could be added in this part of the paper, these specific parts are highlighted due to their particular importance.

In several instances, governments have felt the need to intervene and 'legalise' standards in order to justify the increased cost and impact upon society. The process of establishing regulatory arrangements for setting standards has frequently exposed conflicts between private sector interests and public ones. Partly, this might be because standards cannot merely represent rules – as in law-making (the idea on having neither purely rules-based nor purely principles-based standards is further developed in the next chapter).

INTERACTION WITH CORPORATE REPORTING

It is also important to consider the possible interaction of standards discussed in this paper with developments in corporate reporting. In the current business world, there is an increasing demand for information in non-financial areas such as corporate social responsibility (CSR) or environmental, social and corporate governance (ESG) issues. These developments have, and will continue to make, an impact on corporate reporting and on the sources of information that investors will refer to prior to making their investment decisions.

Standards can play a role in this development, especially when it comes to sustainability reporting, by providing companies with a common language for disclosing non-financial information.

Accountancy Europe has issued a Cogito publication on *The Future of Corporate Reporting – creating the dynamics for change*[15] touching upon future developments in corporate reporting and especially how the latter can work, as a key element in channelling funds from/to investors.

1.2 WHAT IS STANDARD SETTING?

WHAT IS STANDARD SETTING & WHAT IS A STANDARD SETTER?

To understand the standard setting process of today, it is essential as a first step to consider its definition.

> *"Standard setting is the process of determining a common set of characteristics for services." (OECD)*[16]
>
> *"A standard setting organisation means an entity that is primarily engaged in activities such as developing, coordinating, promulgating, revising, amending, reissuing, interpreting, or otherwise maintaining […] standards applicable to a wide base of users outside the standards developing organisation. It aims to generate the acceptance or proliferation of such new standards based technologies, products or services." (US legal)*[17]
>
> *"A standards organisation, standards body, standards developing organisation, or standards setting organisation is an organisation whose primary activities are developing, coordinating, promulgating, revising, amending, reissuing, interpreting, or otherwise producing technical standards that are intended to address the needs of some relatively wide base of affected adopters." (Wikipedia)*[18]

Therefore, as highlighted above in the definitions, whilst standard setting is the process by which an acceptable benchmark is established, this very much remains an ongoing process with existing standards having to be revisited as well as new standards being proposed as appropriate. Standard setters need to facilitate the smooth operation and oversight of the standard setting process to ensure that an acceptable level of quality is achieved and maintained. In particular, standard setters are expected to engage with stakeholders to understand their views and potential concerns with an existing or proposed standard. Ultimately, the standard setter seeks to

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[15] Accountancy Europe (previously FEE), (2015). *The Future of Corporate Reporting* [online] Available at: https://www.accountancyeurope.eu/publications/future-corp-rep/.

[16] Organisation for Economic Co-operation and Development (OECD), (2011). *OECD Policy Roundtables Standards Setting 2010* [online] Available at: http://www.oecd.org/daf/competition/47381304.pdf.

[17] Standard Setting Organization [SSO] *Law and Legal Definition.* (n.d.) In: US legal [online] Available at: https://definitions.uslegal.com/s/standard-setting-organization-sso/.

[18] *Standards organization*. (2017) In: Wikipedia [online] Available at: https://en.wikipedia.org/wiki/Standards_organization.

gain the stakeholders' buy-in for any new or revised standard to help add credibility to the finalised product and authority or the standard setter.

The activities of a standard setter – which are further analysed below – are aimed at ensuring that standard setting will achieve its key purpose from the inception of a project on a new or revised standard through to the publication of a final standard.

WHAT IS THE PURPOSE OF STANDARD SETTING?

Standard setting can serve several purposes depending on the subject matter the standards in question cover. With reference to standards initiated for the profession, key intentions of standard setting seem to be creating:

- a benchmark for quality
- increased consistency in relation to the provision of services and their reported outputs with a high level of acceptance by all stakeholders

Also, standards seem to allow for:

- consistency of financial statements and therefore allow broader access to capital
- generating confidence in the quality of information in the market as well as market stabilisation (by avoiding systemic risks)
- global mobility for professionals (in case of global standards)

In addition, an overriding objective of standard setting is to ensure that institutional arrangements are properly responsive to public interest at a global level[19].

The standards covered in this paper are generally applied by professional accountants who are used to applying their judgement. Therefore, when it comes to standard setting, the approach favoured by the accountancy profession is for standards to establish certain key principles, but to allow room for professionals to exercise their judgment as to the best means of applying those principles in any given situation. However, many would argue that standards increasingly include specific rules, i.e. certain requirements over which the accountant cannot exercise an alternative judgement, primarily due to the increased role and activities of regulatory bodies.

EXAMPLE

The ISAs split the material into 'requirements' and 'application and other explanatory material'. This has led some to claim that the audit has very much been turned into a compliance type service. The key objective seems to be to satisfy a regulator by ensuring that all of the stated requirements have been met.

What many perceive as the most appropriate approach often includes a mixture of principles/objectives, requirements, procedures and guidance. Most importantly, it is key to set out from the very beginning (while preparing the standards) clear objectives and principles for the standards; what is the change that they should bring about? Once the objectives are clear, the application of professional judgement will be enhanced. With the right level of guidance, this should also lead to a sufficient level of consistency in application.

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19 International Federation of Accountants (IFAC), (2011). *International Standard Setting in the Public Interest* [online] Available at: http://www.ifac.org/system/files/publications/files/PPP3-Standard-Setting-in-the-Public-Interest.pdf.

Standards should not be applied in a tick-the-box fashion. Neither purely rules-based nor purely principles-based standards[20] currently exist or are likely to be produced[21]. Experience has shown that standards will always exist somewhere between rules and principles. The key issue would be to encourage applying the spirit of the standard – its principle – which can lead to exercise of professional judgement but also ensures standards' robustness and adaptability.

Proportionality is also a key factor that needs to be considered by standard setters and should form part of the cost-benefit analysis that is undertaken. In addition, cultural norms can obviously impact on the standard setting process. Experience has shown that for instance small audit firms are often confronted with significant implementation issues, as adaptation to their needs is a difficult and time-consuming process.

EXAMPLE

Recently, the international auditing standards have been subject to criticism from certain stakeholders who claim that the ISAs are not proportionate and are therefore unduly burdensome for the auditors of small and medium sized entities. Furthermore, others claim that the ISAs are hindering innovation in the audit process. Therefore, it has been suggested that international audit standards need to place greater focus on satisfying the objectives and less on the requirements that are necessary in order to satisfy those particular objectives.

In conclusion, standards bring added value as they do serve as a benchmark of quality on a global scale. Such standards serve as a means of improving the professions' initiatives by sharing best practices worldwide and ensuring a certain level of harmonisation. A common set of principles which are widely accepted and applied can undoubtedly increase stakeholders' confidence in the profession and the outcome of the application of standards. This will eventually enhance markets' operation due to the increased comparability and transparency that they bring. The difficulty, however, lies in setting those principles; i.e. striking the correct balance between principles-based and rules-based standards.

WHAT ARE THE OBJECTIVES OF STANDARD SETTERS?

Standard setters play a key role in ensuring the smooth operation of the standard setting process. In particular, one can divide the key objectives of standard setters into the following stages:

DEVELOPING STANDARDS

A standard setter's key objective is to develop high quality standards that meet the needs of the market.

GENERATING ACCEPTANCE BY ISSUING DRAFT STANDARDS AND PERFORMING DUE PROCESS CONSULTATIONS

Standard setters should ensure that there is a transparent and robust due process, designed to determine how stakeholders react to the introduction and promotion of individual standards. Overall, standard setters need to ensure that there is enough support from the stakeholders when it comes to justifying the issuance of a standard and its usefulness. As further explained in the paper, publishing high quality standards and adhering to best practice governance procedures remain indispensable traits for a standard setter to gain acceptance.

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[20] Principle based standards provide guidance and can be applied to the infinite variations in circumstances that arise in practice and may prevent the development of a mechanistic, tick-the-box approach to decision-making. On the other hand, compliance under rules based standards is easier since the requirements are prescriptive and leave little room for misunderstanding.

[21] Global Public Policy Symposium, (2008). *Principles-based accounting standards* [online] Available at: http://pwc.blogs.com/corporatereporting/files/principlesbased_accounting_standards.pdf.

INTRODUCTION AND DISSEMINATION OF FINAL STANDARDS TO THE MARKET

Another important standard setter's objective is to introduce and promote standards that respond to the current needs of the market. Standard setters are expected to objectively present the benefits of such standards to the market.

FACILITATING STANDARDS' IMPLEMENTATION

Should standards receive enough support in the market, the next step is to encourage their adoption and initiate their implementation. Standards' endorsement should be not confused with standards' enforcement. Standard setters should ensure that they allow sufficient time for those impacted by standards to change their existing practices as necessary to help facilitate the implementation of new or revised standards. This helps to ensure that standards are well received and are being implemented as originally intended.

ENSURING THE RELEVANCE OF STANDARDS BY REVIEWING AND UPDATING

Standard setters also need to make sure that the issued standards are still relevant. They are responsible for revising existing standards where there is evidence that the standards no longer correspond to professional or market circumstances and needs. This is particularly relevant when it comes to changes in technology, in business and also in wider society. Therefore, having principle-based standards can prove to be a more sustainable approach especially in times of rapid changes.

To achieve the above, standard setters need to stay in regular contact with stakeholders at all stages of the standard setting process. The primary objective of this exercise is to help ensure that standards serve the actual needs of stakeholders including the profession. Interaction with individual stakeholders as well as the importance of serving the public interest can be two challenging factors for the standard setter. The impact of these two key issues is further discussed in the following sections.

2. KEY ISSUES RELATED TO STANDARD SETTING

2.1 STAKEHOLDERS AND THEIR NEEDS

WHO ARE THE RELEVANT STAKEHOLDERS?

Stakeholders may be defined as:

> *In more general terms: "A person with an interest or concern in something, especially a business." (Oxford Dictionaries)*[22]
>
> *More specifically: "A person, group or organisation that has interest or concern in an organisation. Stakeholders can affect or be affected by the organisation's actions, objectives and policies." (Oxford Dictionaries)*[23]

Overall, stakeholders may range from individuals, private entities, professional and other bodies to politicians and regulators. As mentioned above, stakeholders can approach organisations – in this case standard setters – depending on their interests and concerns. Their purpose is to influence the standard setters' agenda and the content of proposed standards. Interestingly, the term 'stakeholders' does not feature in any of the definitions of the term 'standard setter' listed previously. However, in recent times, the audience with an interest in the work of standard setters which have a key impact on the accountancy profession has been growing, eased by nearly unlimited digital access to their work. Stakeholders currently include – among others – investors (including shareholders and owners), analysts, businesses (including management), trade unions (including employees), governments (including relevant regulatory and tax bodies), professional services firms as well as practitioners,

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[22] *stakeholder*. (n.d.) In: Oxford Dictionaries [online] Available at: https://en.oxforddictionaries.com/definition/stakeholder.
[23] *stakeholder*. (n.d.) In: Business Dictionary [online] Available at: http://www.businessdictionary.com/definition/stakeholder.html.

professional bodies, Non-Governmental Organisations (NGOs), academics, and society at large. This could be attributed to the importance and success of the standards in the market, including the largest capital markets. This is also partly due to the growing regulatory demands stemming from successive financial and economic crises, placing stricter requirements on standard setters' and corporate management's accountability.

EXAMPLE

Entities listed on the CAC 40 (Cotation Assistée en Continu) in France, the DAX (Deutscher Aktienindex) in Germany and the FTSE (Financial Times Stock Exchange) in the United Kingdom need to prepare their consolidated financial statements in accordance with IFRS as adopted by the EU. Likewise, these financial statements will be audited using ISAs or standards which are substantively derived from the ISAs. Indeed, investment decisions will be impacted by the numbers which an entity reports. It is therefore essential that investors have trust in the standards from which those numbers have been derived and also in the assurance which is provided on them.

Governments have a legitimate interest in such standards as ultimately, they can impact upon public interest objectives such as the financial stability and prosperity, long term investments, taxable revenues and others.

EXAMPLE

Financial statements are used as the basis for determining an entity's taxable profit in a number of countries, starting with the accounting profit and then making any adjustments which are required by tax legislation to arrive at the taxable profit.

In addition, the aftershocks of the financial crisis have highlighted the importance of the public sector producing transparent and relevant financial information.

EXAMPLE

There have been developments within the EU and elsewhere to encourage countries to prepare their accounts on an accruals basis of accounting, as opposed to a cash one, and preferably in accordance with IPSAS or IFRS.

On the other hand, certain political bodies have from time to time seen standards as a contributing factor that amplified the consequences of the crisis on banks, financial markets and the overall economy[24].

EXAMPLE

This was made clear by the pressure put on the IASB by governments and regulators to make amendments to the accounting standard that covers the recognition and measurement of financial instruments to move to an expected credit loss model. This ultimately ended up with the IASB issuing a new standard in this area, IFRS 9 *Financial Instruments*, which after several political debates at EU level, has now been adopted with an effective date for accounting periods commencing on or after 1 January 2018.

This example serves to illustrate that stakeholders are not all equal and that certain stakeholders have more influence than others. This can be attributed to a number of factors such as their political leverage, their authority, their role and reputation but also their past record of taking forward initiatives. The most powerful and influential stakeholders are usually able to engage more easily with the relevant standard setter.

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[24] Bengtsson, E. (2011). The IASB, the EU and the global financial crisis. *Critical Perspectives on Accounting*, (Vol 22, Issue 6). p 567–580.

In some cases, the standard setter itself solicits responses from specific stakeholders or invites them to table their views on specific issues. This is a good practice provided the process reflects the relevant stakeholders' population and in the right proportions.

EXAMPLE

This approach was adopted by the IESBA in 2014 during its consultation process on its *Non-Compliance with Laws and Regulations* project. To seek to get enhanced engagement on this topic, a series of roundtables involving key stakeholders were held around the globe.

In conclusion, in most cases standard setters have to deal with a pool of diverse interests and consequently, often face incompatible expectations. Addressing such diverse needs can be a challenging task with several conflicting interests to resolve. Therefore, the need for key standard setting personnel to display strong political skills is sometimes as important as the need for them to have strong technical skills.

CAN STANDARD SETTERS ADDRESS STAKEHOLDERS' EXPECTATIONS?

Objectively, standard setters have to deal with divergent stakeholders' needs and expectations. Considering also that some stakeholders have easier access to standard setters than others, it is a daunting challenge for standard setters to address all stakeholders' needs on an equal footing.

Keeping all stakeholders satisfied is without doubt an impossible task for standard setters. In fact, should standard setters attempt to address the needs of all stakeholders, the mission of the standards' development could be hampered and, in a worst-case scenario, derailed. Additionally, it is inevitable that some stakeholders will succeed in prevailing over others. Great care has to be exercised by standard setters to ensure that the standard setting process is not manipulated to the detriment of the quality of the particular standard concerned.

All in all, standard setters have to make difficult choices. Expectations are that standard setters do as much as possible to gather input from a variety of stakeholders. This involves an open, transparent, robust and high-quality process of public consultation. This also includes the provision of the opportunity for stakeholders to interact with the standard setters on a bilateral or multilateral basis during the standard setting process. Standard setters are then expected to find the right balance between stakeholders' feedback and expectations and the (initial) mission and objectives of the standard setter.

HOW TO INTERACT WITH STAKEHOLDERS?

Overall, a successful and accepted standard setting process must involve interaction with relevant stakeholders through an arms-length (independent) and formal due process that also includes accountability and transparency. This due process can take many forms: setting up consultation groups, advisory groups, issuance of discussion papers, extended consultation in various forms and the issuance of (re-)exposure drafts.

Possible impact while engaging with stakeholders can vary:

- On one hand, many stakeholders can have unique insights into certain issues within their remit. They can secure resources to assist with standard setters' decisions or projects. Involving stakeholders can build trust, which can ultimately lead to increased consensus in support of the end product. It can also increase transparency and lead to better decision-making[25].
- On the other hand, asking for input, when decisive action is needed by the standard setter is time consuming and can give the appearance that the standard setter does not have strong leadership abilities. In addition, if standard setters involve stakeholders but do not take their views into account, they might give the impression that expectations have not been met[26.] This can lead to distrust in the

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[25] Chron, (n.d.). [online] *Advantages and Disadvantages of Stakeholders*. [online] Available at: http://smallbusiness.chron.com/advantages-disadvantages-stakeholders-32179.html.
[26] Ibid.

standard setter and most importantly to a lack of acceptance by the stakeholders in the standard setter's product and process.

Interaction with stakeholders is a crucial part of the standard setting process. Standards are developed to increase trust and serve the market's needs. For this reason, stakeholders' feedback should be indicative of whether this has been achieved, especially where different groups of stakeholders have expressed different views. When the feedback of particular stakeholders is not reflected in the finalised standards, there may be repercussions which need to be managed carefully. When stakeholders' input is ignored to such a magnitude that the standard setter's reputation is brought into disrepute, such standard setting will be useless.

At the same time, as the audience of standards has grown extensively, standard setters are expected to consider as many views as possible – which takes time. Timeliness is a factor that should be taken into account when interacting with stakeholders. Standards should be finalised and issued in a timely fashion and therefore consultation with stakeholders should be built into the process so as not to cause significant delays to the envisaged standard setting schedule. However, sometimes stakeholder input may lead to the need to significantly revise the previously taken approach, which may then lead to the need for more time to be able to issue high quality standards.

Serving the public interest should be placed above addressing the interests of specific stakeholder groups, especially if in conflict. The following section will touch upon the importance of addressing the public interest as part of standards' development but also the difficulties of defining it.

2.2 THE PUBLIC INTEREST

WHAT IS THE PUBLIC INTEREST?

> *"The public interest is the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy." (IFAC)*[27]

Whilst we acknowledge the efforts made by IFAC in this area, we continue to believe that defining the public interest is a challenging – if not impossible – task. This is mainly because of the vagueness of the concept and the different interpretations given to it by different stakeholders around the world. All in all, it is rather unclear what the public interest represents. Nevertheless, on a regular basis, not only governments and politicians but also regulators and decision-makers claim that their views represent the public interest. Therefore, it is important from the standard setting perspective that this matter is given particular attention. Following a review of various literature, for the purpose of this paper, the public interest can be referred to as the "welfare of the general public (in contrast to the separate and possibly selfish interest of a person, group, or firm) in which the whole society has a stake and which warrants recognition, promotion, and protection by the government and its agencies."[28]

Considering the definition, as set out above regarding the welfare of the general public, it might be easier to describe the public interest by what it should not be or in other words what it should not represent. For instance, the public interest should not be about interests coming from one or a few particular individuals or groups. Also, the public interest does not necessarily include everyone, the benefits of serving the public interest may be perceived rather than objectively determinable and they need not be shared by everyone[29].

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[27] International Federation of Accountants (IFAC), (2012). *A Definition of the Public Interest* [online] Available at: https://www.ifac.org/system/files/publications/files/PPP%205%20%282%29.pdf.

[28] *public interest*. (n.d.) In: BusinessDictionary [online] Available at: http://www.businessdictionary.com/definition/public-interest.html.

[29] Van Mourik, C. (2012). *Response to the IASB 's DP/2013/1 A Review of the Conceptual Framework for Financial Reporting* [online] Available at: http://eifrs.ifrs.org/eifrs/comment_letters/27/27_3255_CarienvanMaourikOpenUniversityBusinessSchool_0_OpenUniversityBusinessSchool.pdf.

As further elaborated below, it is not straightforward determining how to serve the public interest. Public interest is a flexible, evolutive and adaptable concept. Defining it is immediately reducing it. The desired outcome may differ for each occasion. An important condition would be the willingness to serve the public interest. Also, another condition would be to follow certain principles which can work as drivers on how to pursue the public interest.

THE ROLE OF THE PUBLIC INTEREST IN THE PROFESSION

> *"An accountant is the man of confidence for social and economic life." (Limberg)*[30]

Serving the public interest in the profession remains of paramount importance. Through time, it has become more and more crucial to ensure that the public interest remains prioritised in the profession's activities. Applying the public interest in standard setting can contribute to avoiding prevalence of specific group interests in the standards' development process and ensuring that they can have long lasting benefits for society as a whole.

Before making important decisions in relation to the development, revision or finalisation of a standard, standard setters are expected to look back at their initial mission and make a judgement call on the basis of their primary responsibilities. This is to seek to safeguard that standards will continue reflecting the values embodied in that mission in the long-term instead of responding to short-lived agendas set out by specific interest groups.

HOW TO DEAL WITH THE PUBLIC INTEREST?

> *"Applying a detailed definition [of the public interest] is likely to result in unintended consequences" (ICAEW)*[31]

There are no specific ways suggested on how to serve the public interest. Pursuing the public interest cannot be forced into a one size fits all model by trying to come up with a specific definition, terms or guidelines which would be an exercise in vain. Standard setters should apply a great deal of judgement in order to achieve the desired outcome, in line with the public interest. Keeping this in mind, a number of principles to be considered by standard setters have been set out below.

First of all, standard setters should proceed with an impartial assessment of all interests and needs before taking any decisions. Decisions taken on a public interest basis do not necessarily go along with what the business world perceives as an economic cost and benefit analysis. Experience has shown that specific interests, such as for example commercial interests, can lose their importance through time and eventually be abandoned. Public interest should aim for long term initiatives expected to have a beneficial impact to society. In particular, standard setters should consider whether any proposed initiative will bring any positive behavioural change to the profession or to the affected stakeholders.

Some are of the view that standard setters need also to reflect on who is going to benefit from this change. In everyday life, the 'public interest' and the 'common good' are often used interchangeably. The common good includes everyone, the benefits are objectively determinable, and they are shared by everyone[32.] Nevertheless, the public interest and common good should be distinguished. Any specific personal, political or specific group

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[30] Accountant, (2015). Approximate translation of: "De *accountant is de vertrouwensman van het maatschappelijk verkeer"* by Théodore Limperg jr. [online] Available at: https://www.accountant.nl/magazines/accountant-2015-q2/aartsvader-van-de-nederlandse-accountants/.

[31] ICAEW, (2012). *A Definition of the Public Interest* [online] Available at: http://www.icaew.com/~/media/corporate/files/technical/ethics/public%20interest%20summ%20web.ashx.

[32] Van Mourik, C. (2012). *Response to the IASB 's DP/2013/1 A Review of the Conceptual Framework for Financial Reporting* [online] Available at: http://eifrs.ifrs.org/eifrs/comment_letters/27/27_3255_CarienvanMaourikOpenUniversityBusinessSchool_0_OpenUniversityBusinessSchool.pdf.

interests should be ignored before taking any decision. In other words, the public interest is not the same as what may be of interest to the public[33].

In today's world where economic globalisation has progressed much further than political globalisation, which is creating perverse incentives and opportunities for private gain at public expense, the public interest deserves to be taken seriously[34]. Asserting that an action is in the public interest involves judging whether the action or requirement to change behaviour will benefit the society overall and in the long term[35].

There is no doubt that the public interest is perceived differently around the world. One cannot claim that there is one universal definition for the public interest. The public interest varies depending on the country's history and culture.

Standard setters would also need to acknowledge that the public interest is a dynamic term and changes over time. The proposed standards should bring a long-lasting effect to society. However, as society's needs change through time, standard setters should make sure that the public interest angle embedded in them remains topical and effective.

In conclusion, there is no commonly accepted definition of the term public interest while its application may also vary. A guiding tool could be to consider whether the expected impact will be beneficial for society in the long term. This is certainly a daunting task for standard setters and it requires not only objective judgement, but also keeping in touch with stakeholders' needs. As concluded in the previous section, standard setters need to listen to comments coming from all sides and make sure they hit the right balance between this feedback and serving the public interest.

[33] Carter, M. and Bouris, A. (2012). *Freedom of information* [online] Available at: https://www.ucl.ac.uk/political-science/publications/unit-publications/134.pdf.

[34] Van Mourik, C. (2013). *The public interest in international financial accounting, reporting and regulation.* In: Van Mourik, Carien and Walton, Peter eds. The Routledge Companion to Accounting, Reporting and Regulation. Abingdon: Routledge, pp. 187–206.

[35] ICAEW, (2012). *Acting in the Public Interest* [online] Available at: http://www.icaew.com/~/media/corporate/files/technical/ethics/public%20interest%20summ%20web.ashx.

3. PROPOSALS FOR CHANGE & COMPARISON WITH EXISTING STANDARD SETTERS

3.1 INTRODUCTION

The previous sections reviewed the current standard setting process and changing environment in which standards are set. The objective of this section is to establish clear principles that could serve as the basis of standard setting in the 21st century. We acknowledge that there are various and diverse views on this topic, and it is therefore essential to emphasise that any list of proposed key principles cannot be exhaustive.

The purpose of the list proposed below, is to facilitate a discussion amongst interested stakeholders as to what could be the most appropriate principles that could be taken into account when considering standard setting. Our proposals seek to take on board lessons from the past, ongoing developments and the ever-changing needs and expectations of stakeholders. This is why better interaction with stakeholders remains absolutely key to make this feasible.

Times have changed since standard setting was introduced to the market. Technological innovations have affected the way stakeholders work and interact with information. Expectations have been raised when it comes to the speed and quantity of information being transmitted to stakeholders. At the same time, there is a strong stakeholder expectation that quality and due process is constantly improved. Stakeholders work at a faster pace and they expect that any benchmarks relevant to their work – i.e. standards – should follow suit.

In addition, the increasing interest in, and focus of policy makers on, standard setting has changed the way standards are perceived by society. Some policy makers and other stakeholders seem to have lost trust in standard setting. There have been significant company failures as well as the recent financial crisis that have led to this stance. This could potentially be attributed to certain standards not having been sufficiently predictive of expected losses or, on the contrary, having had a procyclical effect of accelerating losses. Policy makers have raised concerns as to whether the standard setting of certain standard setting boards remains legitimate. This includes questions on the funding, independence and governance of the standard setters.

Furthermore, the relationship between some standard setters and certain stakeholders seems to have suffered from misconceptions and expectation differences. Stakeholders have expressed the view that they feel estranged from the standard setting process as well as from the standards themselves. Although the reasons for that need to be further explored and discussed, there is a concern that standard setting, particular standards or parts of a standard may lose credibility and fall into disuse as stakeholders feel less connected with their content.

In summation, for these and other reasons, there is a need to re-open the debate as to what the standard setting model for the 21st century could look like. Having given appropriate consideration to this matter, we believe that the key principles that could be enshrined in this model are:

A. legitimacy
B. independence
C. transparency
D. public accountability
E. due process
F. balanced membership

3.2 PROPOSED KEY PRINCIPLES AND CRITERIA FOR STANDARD SETTING IN THE 21ST CENTURY

A. LEGITIMACY

EXPLANATION

In order for a standard setter to have any authority, i.e. ability to set standards that users will follow, it must have legitimacy. This may come from having legal power to set standards or from have the 'gravitas' to command the respect of those ultimately responsible for promulgating and applying such standards.

Standards are expected to serve the market's needs and benchmark best practices among stakeholders. A legitimate standard setting process means that standards can appropriately serve their purpose, within the terms of reference of the standard setter. Trust, quality, innovation, responsiveness and timeliness are key factors to determine the standard setters' legitimacy.

CRITERIA

Stakeholders

- The standard setting processes, governance and oversight processes are widely accepted and recognised by stakeholders. Standard need to be part of a comprehensive set or framework which is adopted and used.
- Standards are perceived as being as relevant as possible to stakeholders' needs.
- The standards are set within the terms of reference of the standard setter.

Timeliness

- Standards are perceived to respond as timely as possible to stakeholders' needs.

Innovation

- Standards are responsive to current technological and environmental developments in the market.

B. INDEPENDENCE

EXPLANATION

Independence in standard setting should permit the issuance of standards without them being affected by any undue influences or conflicts of interest that could compromise them. In other words, for objective decision-making, the board as a whole must be independent from any stakeholder group.

In terms of perceived independence funding is key as standard setters should be free from undue funding pressures. Furthermore, it is essential that a standard setter is not fully dependent on political or corporate donors (either via cash or use of personnel) and likewise should not be unduly

OUR APPROACH

This section outlines what Accountancy Europe believes to be the key principles for standard setting and their criteria.

We have also identified certain areas for improvement:

- legitimacy: timeliness; innovation
- independence: board composition; balanced & sustainable funding model
- due process: overarching criteria, the public interest and integrity
- balanced membership: board nomination process; role of the secretariat

These are discussed in more detail in section 3.4.

influenced by special interest groups or other stakeholders who have a particular vested interest that may not be in the public interest.

CRITERIA

Board composition

- No particular stakeholder group is able to exercise undue influence within the board.
- The composition of the board balances broader and relevant stakeholder representation.
- There are sufficient structures in place to insulate the board from undue political or other external influence.

Balanced and sustainable funding model

- There is a stable funding mechanism to support the board and the public interest oversight body.
- The funding model ensures that contributions to funding are fairly shared and justified among the potential sources.
- The funding model is free from perceived conflicts of interest by sheltering standards setting board members and public interest oversight body members from funding mechanisms.

C. TRANSPARENCY

EXPLANATION

In today's society, there is a demand for even greater transparency in relation to the operation and governance of standard setting bodies. Transparency enhances stakeholders' trust in the standard setter's decision-making process. It can also enable better assessment of the standard setter's strategy and outcome.

CRITERIA

Decision-making process

- The board's strategy and work plan are publicly available.
- The board's decision-making process is transparent.
- Meetings are open to the public.
- Agenda materials and minutes are publicly available.
- Comment letters received on proposals are publicly available.
- Interested parties are able to see how particular decisions were made and why, i.e. the board provides feedback that explains how key issues and comments received were addressed.

D. PUBLIC ACCOUNTABILITY

EXPLANATION

Accountability means ensuring that standard setters are responsible for their actions and ready to redress issues if needed and appropriate. This is expected to take place in a timely manner even where there is negative feedback from stakeholders.

Public accountability is crucial if a standard setter is to fulfil its public interest obligations. This applies to the quality of the final standards, as well as the processes by which it produces and revises such standards including its interaction with stakeholders.

CRITERIA

Relationship with the outside world

- The standard setter and its leadership engage in outreach to key stakeholders.
- The standard setter is able to demonstrate how its final standards are in the public interest and how the board has addressed key stakeholder input in finalising a standard.
- Standards are issued when there is a real necessity to respond to actual market needs as well as to evolving practices and innovation.
- Impact assessment: before the standard is finalised and also after it has been used for a reasonable period of use, the standard setter should evaluate the high-level impact that the standards are going to bring to the market.

E. DUE PROCESS

EXPLANATION

The due process in standard setting should ensure that standard setting is fully responsive to the public interest as well as to stakeholders' needs. Due process should also ensure that the procedure of standard development is accountable and transparent and contributes to enhance standards' legitimacy.

It is essential that stakeholders have confidence in the due process which a standard setter undertakes in relation to its operations and governance. A standard setter should properly engage with stakeholders and seek to ensure that its proposed strategy will deal with the issues which stakeholders believe are appropriate.

CRITERIA

Overarching criteria

- The standard setting and oversight bodies both have separate and extensive due processes to help inform their activities and decisions.
- Standard setting boards should coordinate efforts in topics of mutual interest.

- Standard setting boards are expected to assess before issuance whether the objectives set for the standard at the beginning of the standard setting process have been achieved in the final standard.
- Due process is perceived as fair, transparent and able to balance competing interests, without the influence of undue outside intervention.

Public interest

- Consideration of the public interest is an integral part of the independent standard setting structure, governance and process.
- Any public interest oversight body should have clear objectives, avoid complicated structures and be efficient. It is envisaged that there would not normally be more than one oversight body.
- The composition of the public interest oversight body should be such that it is/has:
    - Members of a broad and balanced range of key stakeholders and is not dominated by any special interests.
    - A funding mechanism that is constructed in such a way that it does not threaten the independence of the oversight body.
    - Authority to approve the board's due process and process for recruitment of new members to the board.

Inclusiveness

- The board has the ability to seek advice of key stakeholders on key decision points in the process.
- There is widespread and public consultation on key proposals so that all stakeholders have an opportunity to provide input and to have their views given a fair hearing.
- The process ensures participation that is inclusive of a wide range of groups within society.

Integrity

- The public oversight body should approve that the 'due process' of standard setting is followed and hence safeguard principles such as independence, transparency and objectivity. The oversight mechanism should not intervene to the point of changing or delaying the standard setting agenda, interfering with the debates, or to second guess decisions reached by a competent board adhering to its due process.

F. BALANCED MEMBERSHIP

EXPLANATION

A board should encompass a set of different criteria. The nomination of the board should be transparent and open to everyone, providing sufficient time for applications. Its members should come from diverse, but relevant, backgrounds in order to be able to gain more acceptability and diversity of input into the standard setting process. However, all board Members should also possess the necessary technical knowledge, especially if standards are of a highly technical nature.

CRITERIA

Board nomination process

- The composition of the board as well as its working groups and advisory groups ensure that key stakeholder groups can actively participate. Key criteria are:
    - The nomination process of the board members.
    - Terms and tenure.
    - Diversity: geographical spread (e.g. common law versus civil law jurisdictions), gender, background etc.
    - Competence/qualifications: The board and its working groups include appropriate and relevant business, professional and technical expertise.
    - Technical Capacity: no stakeholder group is able to dominate or exercise undue influence. Nevertheless, the more technical standards are, the higher the involvement of the technical experts should be.

The role of the secretariat

- The secretariat is independent of vested interests and undue influence from any stakeholders.
- The secretariat is equipped with the necessary technical knowledge.

3.3 ANALYSIS OF STANDARD SETTING FOR STANDARDS UNDER PUBLIC OVERSIGHT

INTRODUCTION

Having looked at some of the principles and criteria that could serve as the basis of today's standard setting process, it would have been an omission not to consider how these could apply to today's existing standard setters. The work being done today by standard setters has evolved through years of development and cooperation with the profession and other stakeholders. These models form the basis around professional standards in Europe and other jurisdictions and safeguard their consistency and quality.

Nevertheless, for the reasons set out at the beginning of section 3 a debate on how standard setting could operate in the 21st century is beneficial to ensure that these standards continue to meet the current and future needs of stakeholders and of society overall.

Among the existential questions raised regarding standard setting in the 21st century, is to whom falls the responsibility of issuing the standards? Who has the right expertise or the right position from an integrity point of view to be really involved in the standard setting process? Is it the profession, the regulators, or other relevant stakeholders, within the appropriate frameworks and with suitable roles?

These questions become more pressing when linked to issues such as resourcing and funding. Is it possible or even desirable to put standard setting in a vehicle completely independent from its main beneficiaries like preparers for accounting and reporting standards, the accountancy profession for auditing standards etc.? And if yes, is it possible to find sufficient funding from other more 'neutral' sources which also benefit from the use of the standards like users, regulators, etc.? Some strongly support that the existing standard setters should be established on a basis completely independent from preparers or the profession, and for instance to cut any remaining link between IFAC and the IAASB, the IESBA and potentially the IPSASB. The purpose of this section is not to answer these questions but rather to touch upon various issues in the standard setting process which stem from these existential questions.

Therefore, the desired principles and criteria set out in subsection 3.2 were compared and contrasted with those applied by existing standard setters that are developing standards under public oversight.

It is important to stress that this section and the paper overall do not intend to produce definite conclusions or set-in-stone views. Therefore, any remarks included in this section can only be put forward as considerations for further change and in no case, can these remarks be construed as an exhaustive list. The purpose of this section is to open the discussion, consider the rapid societal changes taking place around us and explore possible ways forward for standard setting.

As set out in the introduction, the scope of this paper is restricted to international standards, prepared under public oversight, which cover accounting, auditing (including internal quality control) and ethics and independence. The paper also addresses accounting standards in the public sector, where this is relevant[36]. Accordingly, this section will consider the structure and governing bodies of the following standard setters:

- Public Interest Oversight Body (PIOB) & Monitoring Group (MG):
    - International Auditing and Assurance Standards Board (IAASB)
    - International Ethics Standards Board for Accountants (IESBA)
        - Both supported by the International Federation of Accountants (IFAC)
- Public Interest Committee (PIC):
    - International Public Sector Accounting Standards Board (IPSASB)
        - Supported by IFAC
- Monitoring Board:
    - IFRS Foundation (International Financial Reporting Standards):
        - International Accounting Standards Board (IASB)

[36] Please go back to Figure 1 of section 1 for further details.

EXISTING STANDARD SETTING MODELS IN OTHER SECTORS AROUND THE WORLD

Standard setting is a commonly accepted process in several other professions and areas of expertise. Indicatively, some of the most widely used international standards are the ISO International Standards for a wide range of industry applications, including the International Aviation industry and the Telecoms industry.

It is not the purpose of this Paper to analyse in detail the due process of these standard setters. It is nevertheless worthwhile to mention a number of concluding remarks on where 'our' professional standards stand in comparison with other sectors.

Overall, it can be said that the complexity, inclusiveness and transparency of the due process of these standard setters are often surprisingly simple and vary depending on the purpose of the developed standards. Some of them function almost exclusively as technical committees of mainly experts, which issue technical standards with minimal oversight over the standard setting process.

CONSIDERATION OF THE EXISTING STANDARD SETTERS UNDER PUBLIC OVERSIGHT

Looking at the respective structures and standard setting processes adopted by globally accepted standard setters, the standards under consideration in this paper are developed and issued by bodies with a strong governance and an oversight structure which have evolved over time. Both the IFAC and the IFRS Foundation have adopted elaborate structures to ensure that criteria such as legitimacy, accountability, transparency, inclusiveness and public oversight are addressed to the maximum extent possible in order to achieve the objective of developing and issuing high quality standards, independent of undue influence, and which are in the public interest. In addition, most of these procedures are publicly visible in order to ensure a certain level of transparency.

WHERE DO WE STAND NOW?

Both the IFRS Foundation[37], together with the Monitoring Board and the Trustees, and IFAC[38], together with the Monitoring Group and the PIOB, have very well-developed processes for their structure and governance. Below are publicly available charts depicting them.

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[37] For further information: IFRS, (2017). *Who we are and what we do* [online] Available at: http://www.ifrs.org/About-us/Documents/Who-We-Are-English.pdf.
[38] For further information: International Federation of Accountants (IFAC). *Structure & Governance*. [online] Available at: https://www.ifac.org/about-ifac/structure-governance.

Structure

The IFRS Foundation is an independent, privately organised, not-for-profit organisation, operating to serve the public interest. The governance and due process are designed to keep the standard-setting independent from special interests while ensuring accountability to our stakeholders around the world.

Figure 2: IFRS Foundation – Structure and Governance

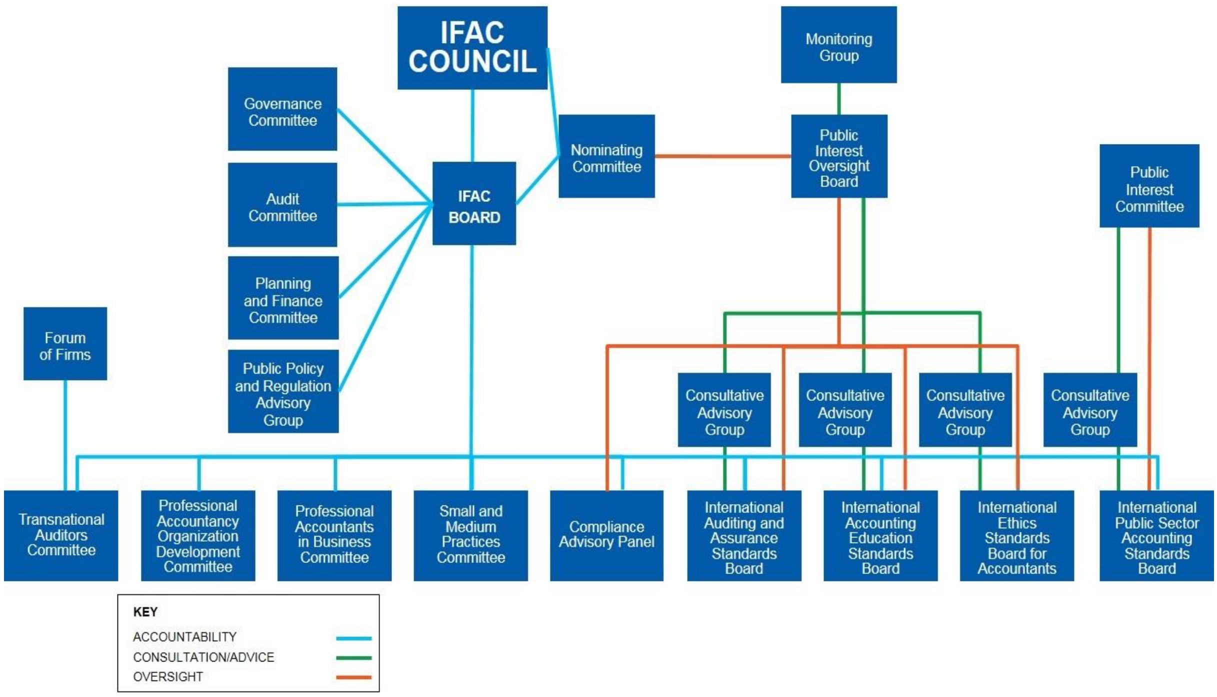

Figure 3: IFAC Structure and Governance

3.4 COMPARISON OF EXISTING STANDARD SETTING MODELS WITH THE KEY PRINCIPLES OF STANDARD SETTING IN 21ST CENTURY

Subsection 3.2 of this paper provided some proposed key principles that could support standard setting in the 21st century. To recall, these principles are:

A. legitimacy
B. independence
C. transparency
D. public accountability
E. due process
F. balanced membership

Accountancy Europe replied to the public consultation launched by the Public Interest Oversight Body (PIOB) on Strategy 2017-2019[39]. In the submitted reply[40], the following idea has been included:

> *"In a nutshell, standard setting can be seen as having three pillars. On one side, there is the preparation of the standards by individuals bringing technical expertise. On the other side, there is the supervision of the standard setting process which aims at safeguarding the public interest. This is conducted by a public oversight body which should be composed of a wide range of stakeholders with regulators only being one part of it. In the middle of these two, there are the boards of mixed composition in which the decision-making on the standards takes place".*

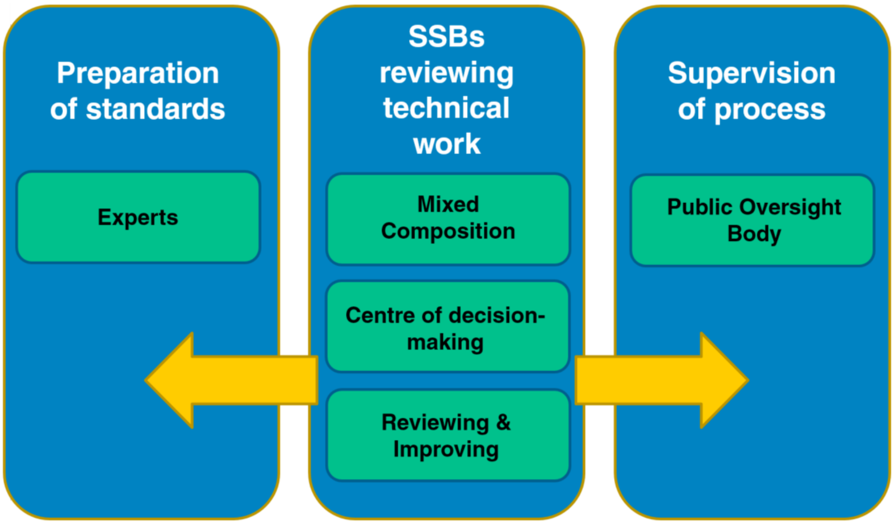

Figure 4: SSBs (Standard Setting Boards)

[39] Public Interest Oversight Board (PIOB). *Publications*. [online] Available at: http://www.ipiob.org/index.php/public-consultation-2016.
[40] Accountancy Europe, (2016). *Consultation response to PIOB on its 2017-2019 strategy*. [online] Available at: https://www.accountancyeurope.eu/consultation-response/consultation-response-piob-2017-2019-strategy/.

On the basis of this model and the proposed principles and criteria set out in subsection 3.2, this part of the paper attempts to identity some of the areas in which there seems to be room for improving the existing standard setting processes. The paper also attempts to propose possible suggestions for improvement which could be seen as a response. **We only discuss those principles or criteria detailed in section 3.2 above where we believe there is scope for change and improvement.**

In the sections below, the paper indicates the areas which were put forward for change combined with possible suggestions for improvement which could be seen as a response. As previously flagged, these indications are not exhaustive and all remarks are made with the purpose of opening a debate on whether the current standard setting approaches are fit for the 21st century.

A. LEGITIMACY

LEGITIMACY

Criteria: Timeliness

Areas put forward to change

- timeliness in issuing final standards
- responsiveness to current developments

Suggestions for improvement

- reduce undue influence of some stakeholders
- upfront clarity of objectives of standard or its changes
- adherence to key principles and criteria throughout due process
- flexible delegation of due process tasks
- better allocation of tasks and division of work (with the secretariat's involvement)

CRITERIA: TIMELINESS

Areas put forward to change

As part of the principle of legitimacy, it is important to develop standards in a timely manner. Undoubtedly, in order to follow highly developed governance and standard setting processes respecting legitimacy and due process, sufficient time is needed. In no case should considerations of timeliness lead to a rushed process, endangering the quality of the product. Nevertheless, standards should be issued when they are still needed. In several instances, it has been remarked that especially the IASB, and to a lesser extent also the boards supported by IFAC, could improve their timeliness in issuing final standards.

Standards should be timely and responsive to current developments and innovation in the market, including technological changes. The fact that standards have moved from being principles-based to being increasingly rules-based, often following pressure from regulators, has definitely made the standard setting process more time-consuming.

It is inevitable that circumstances change over time. The accountancy profession is certainly not the same as what it was ten to fifteen years ago. Its role has developed, partly due to a number of extraordinary factors which have taken place, such as the financial crisis and even the perception of the public interest.

EXAMPLE

Indicatively, we can refer to the IASB work on Insurance Contracts (IFRS 4) which was initiated in 1997 and only finalised in May 2017 as IFRS 17. Another example would be the Leases Project. The IASB and Financial Accounting Standards Board (FASB) added a project on lease accounting to their respective agendas in July 2006, the final standard was issued almost 10 years later in January 2016.

Another example would be for the IESBA the so called NOCLAR project[41], providing guidance for professional accountants on how best to act in the public interest when they become aware of a suspected illegal act or non-compliance with laws and regulations. The project was initiated in October 2009 and was completed in April 2016 taking in total 7 years of development with its implementation facing difficulties in some jurisdictions and its outcome still being debated in some quarters.

Finally, under the IAASB, the Auditor Reporting project[42] was completed in January 2015 while initial discussions took place in 2009. The IAASB took some time to initiate the project, which was meant to contribute to investor's needs by exploring enhancements to auditor reporting in response to the then financial crisis.

Suggestions for improvement

As indicated at the beginning of this section, the standard setters included in the scope of this paper have a highly developed due process. Rightly so, in several cases standard setters need to pass through various stages of consultation in order to ensure the legitimacy and accountability of standards. Nevertheless, the process itself should not delay the initial purpose of standard setting. Delays can sometimes be attributed to external undue influence, often by a very limited number of stakeholders, that manages to hold up the process without presenting workable solutions or other ways forward. In order to achieve timeliness in issuing final standards, it is crucial to identify upfront and with full clarity the objectives and the changes standards should bring in practice. A consultation on the stakeholders' needs and prioritising the board's work accordingly can enhance this. Overall adherence by a board to the key principles and criteria as put forward in the previous section (subsection 3.2) could be a demonstration of its inclusiveness and credibility while being bold enough to push back on this undue influence.

In several instances boards could consider a more flexible application to their work by e.g. assigning or delegating almost the entire process to develop, draft, review after consultation and finalise a specific project to some of the board members. They would still report back to the board but having them leading the project could speed up the process.

In the previous sections, we have flagged the importance of keeping in touch with the relevant stakeholders to make sure that standards address their needs. That should indeed be the case. Nevertheless, it is also important to keep in mind that it would ordinarily be impossible to keep all stakeholders satisfied. Standard setters should therefore try to reach acceptable solutions to ensure that the standard setting process remains in line with the expected timeline and objectives.

It could also be considered – especially for boards supported by IFAC – whether fine-tuning of the drafting of standards should be done by the entire boards or whether the staff or designated working groups/task forces could assume (part of) this role. Without exerting undue influence and considering

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[41] International Federation of Accountants (IFAC). *NOCLAR*. [online] Available at: http://www.iaasb.org/projects/noclar.
[42] IAASB. *Auditor Reporting Project*. [online] Available at: https://www.iaasb.org/projects/auditor-reporting.

that it is sufficiently staffed, the secretariat could take up more ownership of the executive part so that the board has more time to draft its strategy and think in the long term. Better allocation of tasks and division of work can contribute to increasing timeliness.

As suggested in the previous section, it needs to be reflected on as to whether new or revised standards are responsive to the actual market's needs in terms of their timeliness, as well as to evolving practices and innovation.

LEGITIMACY

Criteria: Innovation

Areas put forward to change

- lack of initiatives addressing technological developments

Suggestions for improvement

- embed digitalisation in the boards' strategy and standards
- monitor and research how innovation and digitalisation in the market will influence standards
- swiftly respond to digital developments and innovation
- introduce digital collaboration tools into consultation processes

CRITERIA: INNOVATION

Areas put forward for change

Responsiveness to innovation, especially when it comes to technology and digitalisation, are key concepts that need to be taken into account by all the standard setters falling within the scope of this paper. It would be advisable that the boards, as well as their relevant working groups, prioritise these concepts when reflecting on strategy; when taking decisions to develop any new or revised standards; in relation to consideration of internal working methods; and when collaborating with stakeholders. Technological innovations are progressing rapidly and this inevitably affects working methods as well as stakeholders' expectations.

Questions relevant to the profession such as: 'is reasonable assurance still a leading principle, or should stricter standards be followed?' are raised in the light of the recent influence of IT developments and other innovations which are becoming more and more significant. Digitalisation is revolutionising the way companies record transactions and store data. It is important that the boards understand how these concepts impact on the environment that their standards address in order to develop standards that are relevant in the modern age.

Indicatively, when looking at the current work programmes of the existing standard setters, it is difficult to find any initiatives addressing or even exploring the issues of technology and digitalisation.

EXAMPLE

Exceptionally and only very recently, the IAASB Data Analytics Working Group has released a Working Group Paper: *Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics*. The purpose of this paper is to explore emerging developments in the effective and appropriate use of technology, including data analytics, to enhance audit quality[43]. Although this is a positive indication, it was only launched very recently and can therefore only be seen as a starting point.

[43] International Federation of Accountants (IFAC). *Data Analytic*s. [online] Available at: http://www.iaasb.org/projects/data-analytics.

Considering the current work programme of both the IESBA and the IPSASB, there seems to be no active discussion or work on the impact of technology and digitalisation, at least as far as can be inferred from any public references. Only very recently[44], the IESBA launched a questionnaire[45] which attempts to explore the trends and developments in technology and innovation.

In July 2015, the IASB acknowledged the importance of technology in its *Review of Structure and Effectiveness*[46]. The report concludes that a network of experts should be established to advice on technological developments and their impact on standards. Nothing specific seems to have materialized since then, while technological achievements keep advancing at a tremendous speed. Other than that, the IASB has also addressed the use of extensible Business Reporting Language (XBRL).

Technology and its implications thereof, have potentially wide-reaching implications on the work of the respective standard setters. Therefore, there is a need to ensure that standard setters are appropriately and in good time considering the impact of technology on their respective work programmes as well as on their methods of operations.

Finally, as far as the collaboration with stakeholders is concerned, a significant part of the resources of the boards and their staff are spent analysing comments on consultation documents, which is currently being done on the basis of word or pdf response letters to questions and/or free-form general comments.

Suggestions for improvement

As part of the key principles included in the standard setting system of the 21st century (see section 3.2), standards are expected to be responsive to current developments and innovations in the market. Times have changed since standard setting was first introduced and technology has significantly impacted the way stakeholders work and interact with information. Also, expectations in relation to the speed at which new or revised standards can be produced have been raised as a result of the ongoing technological innovations.

Experience has shown that all existing standard setters have the potential to improve their responsiveness to current digital developments and innovation in the market. The boards need to remain up to date with such developments as well as open to suggestions coming from stakeholders to enable them to respond appropriately and swiftly.

Also, further research appears needed by the existing standard setters in order to see how new technology and digitalisation can influence todays' standards. In fact, these concepts could be embedded in the strategy and

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[44] April 2017
[45] IESBA, (2017). *IESBA Strategy Survey Questionnaire April 2017* [online] Available at: http://www.ifac.org/system/files/uploads/IESBA/IESBA-Strategy-Survey-April-2017.pdf.
[46] IFRS, (2015). *Trustees conclude 2015 Review of Structure and Effectiveness of the IFRS Foundation; propose amendments to Constitution* [online] Available at: http://www.ifrs.org/Alerts/Governance/Pages/Trustees-conclude-review-of-structure-and-effectiveness-of-the-IFRS-Foundation.aspx.

addressed in all working papers when preparing any new standard or revising an existing standard.

Being responsive to the market's use of technology, as well as the overriding impact of digitalisation, would be considered part of a legitimate standard setting process. Such a process implies that standards can sufficiently serve their purpose. Innovation, as well as trust, responsiveness and timeliness, are key factors in determining standard setters' legitimacy.

As far as internal working methods and collaboration with stakeholders is concerned, in addition to or instead of comment letters, the introduction of modern collaborative digital software tools could greatly contribute to more efficient and effective ways to analyse comments received on consultation documents.

INDEPENDENCE

Criteria: Board composition

Areas put forward to change

- perceived lack of independence from primary users of standards
- lack of technical expertise of some other Board member
- perceived imbalanced board composition
- lack of commitment partly due to lack of remuneration
- standards are used by regulators as a primary means of achieving compliance

Suggestions for improvement

- balanced membership combining technical, policy, regulatory and practical backgrounds
- introduce remuneration for the Board members
- increase primary user members in the IASB
- ensure half of the IAASB members are practitioners
- embrace members with technical and practical expertise in the IESBA
- enlarge the IPSASB with private sector experts

B. INDEPENDENCE

CRITERIA: BOARD COMPOSITION

Areas put forward to change

The composition of the boards is a thorny issue which seems to recur in several stakeholders' discussions. In some cases, this regards the professional background of the board members while in others the lack of balanced membership or the lack of perceived transparency in the nomination of the board members appears to be the concern. In order to explore the issue of composition further, each standard setter needs to be addressed separately.

Recognising the need of the boards to consider global – and not regional – implications while setting out international standards, there seems to be a trend towards increasing the membership by regulators on the boards. In some cases, the expectations of the regulators do not seem to be directly linked to the objectives of the standards. This brings the danger that standards are seen more as a means of achieving compliance and enforcement by promoting a tick-the-box mentality with less focus being placed on the importance of principles and the use of professional judgement.

With regards to the IASB, concerns are evident particularly when it comes to the professional background of the board Members. The number of primary users[47] of IFRS in the board, consisting of preparers, investors and other capital providers as well as auditors, seems to be getting lower in recent years risking losing the right balance between them and the secondary users.

It is also important to highlight that the IASB board members are able to devote considerable working hours to the board and receive full remuneration. This is a factor that has probably contributed positively to the members' engagement.

On the contrary, when it comes to standard setting boards under the auspices of IFAC, the board members do not receive any remuneration and in some cases not even reimbursement of travel expenses. Notwithstanding

[47] As defined in the IFRS Conceptual Framework.

the signing of independence declarations, this policy could have negative implications to the members' independence in appearance, as most probably they would end up being paid by their nominating organisation instead of IFAC. In addition, this lack of remuneration can undermine the time and commitment members are willing to invest in the board's activities. This is especially important for the non-professional members, some of which participate on a pro-bono basis.

In addition to this general remark, there is a need to further break down each of the IFAC boards separately (IAASB, IESBA, IPSASB). Taking into account that each IFAC board has a different mission, there is a need to ensure that each of them separately encapsulates the right expertise to be beneficial to their decision-making.

There is no doubt that standards issued by the IAASB require input from those with a high level of technical expertise in audit and assurance and related services to ensure proper consideration of the subject matter. On the contrary, some argue that the scope of the IESBA's remit covers issues which may require less technical expertise and accordingly claim the desire to reduce the number of members with technical expertise. There seems to be a prevailing appreciation that the IEBSA board should encompass a wider range of public interest stakeholders especially with regards to consideration of general matters (like fundamental principles, ethical behaviour etc.) in the IESBA Code of Ethics.

Also, it would appear that the IESBA does not always have regard for the implications of important jurisdictional developments e.g. the introduction of corresponding legislation issued at national, but even more importantly regional (European) levels. This can send conflicting messages to stakeholders and curtail the ability of professional bodies and jurisdictions to adopt and implement the IESBA Code of Ethics.

In the public sector, members seem to come mainly from the public sector with few members from the private sector. Nowadays, it is more and more common to see the public sector turning to the private sector for deliberations and in some cases cooperation. Yet, in the IPSAS board, the membership seems to lack contributions coming from the private sector.

Suggestions for improvement

As far as the composition of the boards is concerned, apart from the generally acknowledged principles of competence, qualifications, technical capacity and diversity in geography, background and gender, the following principles are important to consider:

- No particular stakeholder group should be able to exercise undue influence within the board.
- Any stakeholder member on the board should ensure that they serve the public interest.
- The composition of the board balances broader stakeholder representation.
- There are sufficient structures in place to insulate the Board from undue political or other external influence.
- The board should ensure that a significant number of its members have sufficient practical experience and technical expertise.

When considering the IASB, it is important to ensure that board members have the appropriate background and professional experience, particularly as they receive full time remuneration for their inputs. It would be advisable to increase the number of board members coming from primary users as described above. The number of existing secondary users could be considered as sufficient to achieve the desired goals. Secondary users can contribute not only to the technical expertise of the board but also to the global acceptance of the final IFRS by different jurisdictions.

Balanced membership should be applied to all boards supported by the IFAC as well. It is crucial to involve members with the right background, knowledge and expertise. Each IFAC board has a separate and distinct mission. Therefore, the decision on the right combination of technical, policy, regulatory and practical backgrounds would have to be made taking into account the basis of their reason for being involved.

When we look particularly into to the number of practitioners and non-practitioners, it becomes clear that standards requiring a high level of technical expertise, require more membership from those that apply them, in this case, the profession. This implies that the profession has a key role to play in the IAASB and therefore, having half of the IAASB being composed of practitioners continues to make sense.

Regarding the IESBA, a consideration to reduce the number of practitioners could be discussed as the board is expected to encompass a wider range of public interest stakeholders regarding general matters (like fundamental principles, ethical behaviour etc.) in the IESBA Code of Ethics. However, the need for board level input from those with technical and practical expertise in accountancy, assurance and auditing matters remains key. They are indeed the ones that have an in-depth understanding of the difference between independence of mind (which serves objectivity) and independence in appearance (which is a means by which ostensible conflicts of interest are sought to be mitigated). They can also judge the real effect of a measure both in terms of cost/benefit to independence as well as in terms of added value to the audit or other assurance services.

For the IPSAS board, contributions coming both from the public but also from the private sector can improve the decision-making process by leveraging on the private sector's (IFRS) experience. Accordingly, members of the IPSAS board could come from various other sectors and roles than representatives of public administrations' members.

Regarding remuneration of board members, it could be considered whether remuneration could incentivise further the board members or add to safeguarding their independence. Nevertheless, cost implications should also be taken into account considering that funding resources may not be as capable of expansion as is the case for the IASB.

CRITERIA: BALANCED AND SUSTAINABLE FUNDING MODEL

Areas put forward to change

The accountancy and audit profession is fully supportive of high quality global standards for accounting, auditing, and ethics, including independence. The profession has no intention to unilaterally set its own standards or to seek to become (again) more self-regulated. Therefore, if virtually all or at least a sizeable part of the funding is sourced from the profession, as is currently the case, some may perceive this as endangering the neutrality of the standard setting system.

When considering the IFAC funding system (which is sourced from the profession and controlled by the IFAC) the IAASB, the IESBA and the IPSASB do not seem to be free from perceived conflicts of interest. Despite the fact that it makes sense in the real world to receive funding from those who benefit the most from the standards, the due process should ensure that standards and the standard setting system are and remain responsive to the public interest.

How can this be interpreted in relation to the areas of auditing, ethics and independence in which the profession is the primary beneficiary? If the profession was to cease funding the standard setting activities of these boards, would that be enough to stop the criticism on perceived conflicts of interests and lack of neutrality? And this of course would require a new but acceptable and sustainable funding model.

When considering the IASB and the IFRS Foundation, the same holds true for the sourcing of its budget primarily from industry and the profession. However, as far as the independence of the IASB is concerned, it may help that the board members receive full remuneration from the IASB which contributes to them avoiding them being perceived as having possible conflicts of interest.

Suggestions for improvement

Diversified funding and increasing transparency in the funding process could help in safeguarding the neutrality and integrity of the standard setting models.

Both of these principles would be particularly useful for the IFAC boards. Stakeholders that benefit the most from auditing and independence standards seem to be the most obvious parties to be asked to contribute to such funding. These are investors, stock exchanges, banks, regulators and others including also the accountancy and auditing profession as well as all their international, regional and national representative organisations.

In addition, increased transparency in the IFAC funding process could also safeguard the neutrality of the standard setting models. The sources of funding and especially where and how the funds are controlled and used for standard setting activities should be subject to public disclosure.

As an alternative, there is certainly value in channelling part or all of the funding through an independent infrastructure, for instance to an independent board of trustees, which is transparent and is seen as independent from the accounting and audit profession.

INDEPENDENCE

Criteria: Balanced and sustainable funding model

Areas put forward to change

- sources of funding are not perceived as free from conflicts of interests

Suggestions for improvement

- diversified funding and increased transparency in the funding process
- channel part or all of the funding through an independent infrastructure

EXAMPLE

For instance, most national public oversight bodies overseeing auditors and audit firms, like the French Haut Conseil du Commissariat aux Comptes (H3C) or the UK Financial Reporting Council (FRC), are funded by levies on the auditors and audit firms that they inspect. However, this funding is seen as fully independent of the audit profession as the latter has no influence or control over the funding mechanism, the use of funding or the public oversight body's work and output.

DUE PROCESS

Criteria: Overarching criteria, public interest, inclusiveness and integrity

Areas put forward to change

- composition of public oversight bodies is not always balanced, affecting its mandate
- unclear mission and role of the PIOB
- unclear and untimely communication of the PIOB
- do we need 2 oversight bodies to oversee the board?

Suggestions for improvement

- widen membership of public oversight bodies to members outside of the regulatory community
- reconsider PIOB's role to oversee – not perform – the standard setting due process and board nominations in the public interest
- improve PIOB's communication practices
- one public oversight body with clear objectives

E. DUE PROCESS

CRITERIA: OVERARCHING CRITERIA, PUBLIC INTEREST, INCLUSIVENESS AND INTEGRITY

Areas put forward to change

Having a public oversight body can add legitimacy, but also inclusiveness and integrity by approving that the due process of standard setting is followed. This safeguards principles such as independence, transparency and objectivity – or integrity as flagged in subsection 3.2. In order to ensure that an oversight body completes its mission – serving the public interest – the composition of its members needs to remain balanced.

- IFAC:
  - If we consider the Public Interest Oversight Body (PIOB), we count 2 investors' organisations, 2 academics (ex-regulators) and 3 regulators out of seven members. embers from regulators appear to be over-represented.
  - When it comes to the Monitoring Group, it consists primarily of regulators and legislators, mostly operating in the area of financial services[48].
- IASB:
  - The Monitoring Board mainly consists of regulators[49].
  - Members of the IFRS Trustees are former or current regulators, with a number of stakeholders representing audit networks, preparers and users.[50]. A sub-committee of the IFRS Trustees, called the Due Process Oversight Committee, oversees that the due process has been followed by the IASB.

[48] Current members: The International Organisation of Securities Commission, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the World Bank, the European Commission, the Financial Stability Board, the International Forum of Independent Regulators.
[49] Current members: The European Commission, the Japanese Financial Services Agency, the US Securities and Exchange Commission, the Emerging Markets Committee of IOSCO, the Technical Committee of IOSCO, the Brazilian Securities Commission (CVM), the Financial Services Commission of Korea (FSC), the Ministry of Finance of the People's Republic of China (China MOF).
[50] IFRS. *How we are structured*. [online] Available at: http://www.ifrs.org/About-us/IFRS-Foundation/Oversight/Trustees/Pages/Trustees.aspx.

The PIOB provides independent oversight throughout the entire process of standard setting to ensure:

- that standards' development is fully responsive to stakeholder needs, accountable and transparent
- that the processes of standard development follow the due process and are responsive to the public interest[51]

In practice, however, in several instances it has been noted that it is not clear what the role of a public oversight body is, particularly when it comes to the role of the PIOB. For instance, some believe that the PIOB does not communicate its messages clearly and in a timely manner. Others are not clear whether it acts in line with its initial mandate or not. Also, it would appear that the separate roles and remits of the PIOB and the Monitoring Group are not well distinguished or in line with their initially intended purpose.

Suggestions for improvement

Regarding the composition of the Monitoring Group, the PIOB, the Monitoring Board and the IFRS Trustees, it is necessary to widen the membership to a wider spectrum of stakeholders, considering that the public interest remains pursued.

There is also a need to keep oversight bodies' membership open to stakeholders who have the relevant professional background while also taking into account respective seniority and geographical diversity.

The composition of the public interest oversight body should be such that it is/has:

- members of a broad range of key stakeholders and is not dominated by regulators
- protected from independence threats to its funding
- authority to approve the board's due process and process for recruitment of new members to the board

Some have wondered whether it would be possible for the Monitoring Board and IFRS Trustees to merge into one – although others claim that their roles are complimentary. The idea of merging comes up especially when considering the Monitoring Group and PIOB overseeing the boards supported by IFAC. In the interest of efficiency and to avoid complicated structures, it would make sense to have only one oversight body, with clear objectives.

When considering the PIOB, its roles need to be looked at again to decide how it can best contribute to serve the public interest during the nomination process of board members, as well as during the standard setting due process. The expected role of the PIOB should thus be to oversee that the nomination of members to the independent boards, as well as the due process applied during the course of setting standards, are performed taking into account the public interest.

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[51] Public Interest Oversight Board (PIOB). *What is the PIOB*. [online] Available at: http://www.ipiob.org/index.php/what-is-the-piob.

Nevertheless, it remains important to ensure that the PIOB will not get involved in the standard setting process itself, just like an auditor does not get involved in the management of the companies that he or she audits. The role of the oversight body is to oversee whether standard setting takes place with respect to the public interest. As pointed out in section 3, the oversight mechanism should not be able to intervene to the point of changing or delaying the standard setting agenda, interfering with the debates, or to second guess decisions reached by a competent board adhering to its due process.

Also, it is suggested that the PIOB clearly communicates on whether and how the standards are in line with the public interest, not only when the standards are finalised but also at appropriate key points during the standard setting process. It is also important to work and be seen to work together with the boards towards enhancing their standards in the public interest. This appears to require much earlier communication between the boards and the PIOB, for instance during observations at board meetings, both privately and publicly.

In order to further enhance communication, all public oversight bodies could reflect on a better communication strategy and social media presence.

F. BALANCED MEMBERSHIP

BALANCED MEMBERSHIP

Criteria: Board nomination process

Areas put forward to change

- perceived lack of independence and transparency of IFAC's nomination process

Suggestions for improvement

- establish separate nomination committees for the nomination of practitioners & of non-practitioners and public members, or
- establish one independent nomination committee consisting of half practitioners and half non-practitioners.
- ensuring funding and resources are available

CRITERIA: BOARD NOMINATION PROCESS

Areas put forward to change

Regarding the nomination process, although the PIOB oversees the nomination process to the IFAC independent standard setting boards, several concerns have been raised on the nomination by the IFAC Nominations Committee to these boards. This related to both the perceived lack of independence of the nomination process from IFAC and thus the profession, as well as the perceived lack of transparency surrounding the nomination of board members to these boards.

Suggestions for improvement

The board nomination process should be as transparent and objective as possible. To achieve this, there is a need to increase transparency on the selection criteria and the selection process. More transparency on the selection process, more separation from the accounting profession – or at least more transparency thereof – and effective oversight by the oversight bodies could enhance the way nomination is seen by outsiders and could improve legitimacy. Although public oversight bodies have a role in overseeing the process, it appears that their role has not remediated the perceived lack of independence and lack of transparency of the nomination process. In summation, they need to ensure that the public interest is pursued during the nomination process and that the nomination process is transparent to all.

There are several solutions which could be considered, of which two possibilities are proposed below:

The first one would entail establishing two nomination committees within IFAC:

- For the nomination of practitioners on the boards, nominations could continue to take place as currently practiced (taken forward by IFAC and the profession) considering that this would be based on clear and transparent selection criteria including competence, qualifications, technical capacity and diversity.
- For the nomination of the non-practitioners and public members, a nomination committee that is separate and independent from the IFAC Nomination Committee could be responsible. This committee would be composed of a wide range of relevant stakeholders serving the public interest. Nomination criteria should at least be as clear and transparent as for the nomination process exercised via IFAC's Nomination Committee.

Effective cooperation between these two should bring together the desired overall board composition. The nomination process could be overseen by the PIOB.

The second one would include one single and as independent as-is-possible nomination committee. This committee would consist of half practitioners and half non-practitioners. The committee could be chaired by a rotating chair and the nominating procedure could be overseen by the PIOB.

Nevertheless, it should be flagged that if either of these solutions would be implemented, it would need to be considered whether sufficient funding and resources are available. It may also be necessary to strengthen the role of the secretariat to be able to support the board's work considering the changes the new composition would result in and to make sure the board's agenda stays relevant and effective.

As an overall principle, the public interest at large is served by having a wide range of stakeholders with competences, expertise and experience in the standards under consideration. Apart from the profession, regulators and investors, this could also include preparers of financial and non-financial information, other business representatives, members of corporate boards and of audit committees, non-governmental organisations, employee associations, academics and others.

It could also be added that an over-focus on regulators could result in producing standards which are overly compliance-oriented or applied in a tick-the-box fashion. Regulators are just one of the many stakeholders which make up the public interest at large, but they do not solely represent the public interest. Contributions and views of the many other relevant stakeholders can be equally valid.

BALANCED MEMBERSHIP

Criteria: The role of the secretariat

Areas put forward to change

- too weak and procedural secretariats supporting the IFAC boards

Suggestions for improvement

- strengthen secretariats' role
- ensure independent secretariats with senior staff (potentially seconded)
- ensure secretariats with more ownership while executing due process to allow having a strategically oriented board

CRITERIA: THE ROLE OF THE SECRETARIAT

Areas put forward to change

The secretariat of standard setters can play a key role in enhancing the efficiency of standards' development. The secretariat is expected – among other tasks – to organise the work of boards and/or working and advisory groups and prepare a number of draft documents which reflect the current comments discussed in the standard setting process.

It has been noted, particularly when it comes to boards supported by IFAC, that the secretariat is forced to produce exaggerated numbers of slightly different working documents for the use of different groups, causing significant inefficiencies. This high amount of unnecessary alternative documents can delay considerably the process instead of enhancing it.

It has also been noted that in several cases the secretariats' role remains too weak – maybe not for the IASB – and in this way, allows specific stakeholders to influence its role which should remain independent.

Suggestions for improvement

As is the case within the IASB, the secretariat, in which professional staff should be of a senior level, should embrace a more independent role in the different stages of the standard setting process and the staff should take more ownership of the projects.

It could take up more tasks and roles from the working groups and the board. The secretariat could be responsible of the executive parts of the process while the board would then have adequate time to draft a forward-looking strategy and take decisions.

Indicatively, draft versions of preparatory work could be prepared by the secretariat while the working groups and the board could act more as sounding panels. This would facilitate and speed up the standard making process. In case this would not be feasible due to limited resources, standard setters could also consider the option of hiring seconded staff from firms or other relevant stakeholders. Prerequisites for the right background and expertise should be applied by the standard setters before hiring.

CONCLUSIONS

Having raised all these key issues associated with today's standard setting process, it remains a challenge for this paper to reach any final conclusions. In fact, the intention of this paper is to raise ideas which can only be answered though collective discussion and diverse views which would pave the way to change and future-proof solutions.

Times have changed since standard setting was introduced in the market. Technological innovations have affected the way stakeholders work and interact with information. Businesses reinvent themselves at a breath-taking speed and they and their stakeholders expect that any benchmarks relevant to them would follow suit. Standard setting is expected to evolve and meet the demands of the increased globalisation of business, the investment community and the accountancy profession.

At the same time, while looking at future developments and how standards would interact with more fundamental changes in corporate reporting, it needs to be considered how standards would cope with the increased demand for additional information both in financial but also in non-financial areas such as Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) issues. All these issues play an increasingly important role for investors and have changed the way stakeholders look at corporate reporting. Expectations have also been raised when it comes to the speed and quantity of information being transmitted to stakeholders. The robustness of data and data analytics have gained a pivotal role in the way society and business works and auditing, assurance and corporate reporting cannot remain unaffected by it. Standard setting of the future should embrace these changes and challenges as well as digitisation and contribute to today's innovation. Otherwise, we run the risk of seeing reporting and auditing standards becoming irrelevant which eventually leads to extinction. Technology and digitisation should not just be considered by the existing standard setters but become drivers of their working agendas.

In the eyes of some of the stakeholders, standard setting today appears to be too complicated and advance at too slow a pace. At the same time, several policy makers have raised concerns as to whether the standard setting procedures of certain standard setting boards remains legitimate. This may come as a surprise to some especially considering that in comparison with other global standard setters, financial reporting and auditing standard setters follow an extremely well established due process with several safety checks and well-planned procedures. In fact, there seems to be a case of ‘loss of trust’ in the existing standard setters by a growing number of their stakeholders.

Looking at the structure and process of globally used standards such as the ones of ISO or aviation, the due process of these standard setters is often surprisingly simple and vary depending on the purpose of the developed standards. Nevertheless, no one seems to have doubts about the legitimacy of the standards produced. This is something that raises questions on where the real issue with professional standards lies when it comes to “loss of trust” for the existing financial reporting and auditing standard setters.

It is not easy to give a straight answer on this. First and foremost, it has to be recognised that when the public interest needs to be considered in standard setting, a more sophisticated due process is required. However, practice shows that the due process of the existing reporting and auditing standard setters is over-engineered, extremely procedural and not very strategic. This makes it hard for external stakeholders to understand how it works and most importantly it makes the procedure too slow and eventually out of sync with the needs of the stakeholders which nowadays grow and change at an extremely rapid pace. Some stakeholders have expressed the view that they feel estranged from the standard setting process as well as from the standards themselves. Although the reasons for that need to be further explored, communicated and discussed, there is a concern that standard setting, particular standards or indeed parts of a standard may lose credibility and relevance and fall out of favour or even into disuse.

Issues such as funding, resourcing and composition of boards and public oversight bodies are also related to loss of trust. Some strongly support placing the existing standard setting process in a completely independent vehicle from its beneficiaries like the preparers for accounting and reporting standards and the accountancy profession for auditing standards.

More specifically when considering boards supported by IFAC, the accountancy and audit profession has no intention to unilaterally set its own standards or to seek to become (again) more self-regulated. However, it remains an open question whether it is at all possible to find sufficient funding from other sources like users, regulators, etc. that some stakeholders perceive as being more ‘neutral’.

At the end of the day, to seek an answer to this issue, we need to raise a number of existential questions: to whom falls the responsibility of issuing the standards? Is it the profession, preparers, the regulators, or other relevant stakeholders, within the appropriate frameworks and with suitable roles? It would be detrimental to exclude the preparers and the profession from the standard setting process. The fact however that trust between the existing standard setters and the stakeholders has been broken is an indication that the current state of play needs to be re-considered and if necessary changed.

All in all, for all these and perhaps additional reasons there is an urgent need to join the ongoing debate on standard setting in the 21st century. Discussions on the future of standard setting should be inclusive and open to change and challenge. Innovation, technology but also the recent financial crisis has brought tremendous changes to the way business is done and also to the way policy makers perceive standards. All these are sufficient reasons to discuss the need to change and/or improve the current position.

Accountancy Europe would like to invite readers – including corporates, politicians, regulators, investors, NGOs, accountants and other stakeholders – to participate in our efforts to identify the dynamics for change and contribute to shaping the future of standard setting. We welcome any input and comments to this paper.

Avenue d'Auderghem 22-28, 1040 Brussels

+32(0)2 893 33 60

www.accountancyeurope.eu

@AccountancyEU

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