Dubai, United Arab Emirates
8th February 2018

Monitoring Group Consultation of 9th November 2017:
"Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Boards in the Public Interest"

Response returned by email scan to MG2017Consultation@iosco.org
Response can be made public.

Dear Chairman Everts and Monitoring Group colleagues,

We wish to thank the Monitoring Group for the opportunity to comment on its public consultation on the governance and oversight of audit standards-setting boards. The integrity of financial information is critical for business relations – full stop.

Introduction

Financial Information and its Integrity is the central theme of Sia-MC's work, which focuses on corporate governance and investor relations for public and private companies, and state agencies across the Middle East. The firm's goal in this regard is to assist clients with their strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community and other constituencies. This engenders trust, and ultimately contributes to a company's securities achieving fair valuation.

With Middle East & African capital markets on the cusp of a fundamental shift forward in sophistication and access, SIA-MC founders are offering a niche, bespoke service to meet the full range of client requirements across the region.

The senior managers who signed this letter between them have several decades of professional experience in the field of investor relations, listing requirements, and audit practice.

Of particular relevance to this comment letter, one of the signatories served for nine years on the International Audit and Assurances Standards Board (IAASB) Consultative Advisory Group, from October 2002 just after its inception through the end of 2011, representing the World Federation of Exchanges and its members' issuer services questions. This link may therefore have particular bearing on how the Monitoring Group evaluates this comment, given his role as a non-accountant "outsider" in the reformulation of audit standards and a close-up observer of any pressures that may have been felt during those meetings. Some recollections are shared in the penultimate section of this letter.

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The significance of this consultation as we understand it

Of all the elements required to make a marketplace function, financial information is the most valuable. Information advantage – and the time to make use of it ahead of others - has been the source of greatest gain to anyone who had it. Examples range from the return of special couriers who raced back to London after the Battle of Waterloo in 1815 to today's high-speed algorithm trading shops paying additional fees to 'co-locate' their computer servers immediately next to those of the exchanges themselves. Having that edge is clearly critical, whatever the technology.

On behalf of those who cannot gain access to this edge, the public authorities constantly attempt to level the playing field and offer as much equal access as they can in order to maintain and encourage fairness of the public market. Given that market pricing goes a long way to establish benchmarks for private assets, this effort to attain and maintain fair pricing matters for the entire economy. The need for clear information is equally important in private companies and state-owned enterprises, for they too have stakeholders.

Public interest oversight of audit standards

We well recall the reasons why the Monitoring Group was founded, following the corporate financial reporting failures at the start of this century. We saluted then, as we do now, the association of knowledge and prestige lent to this effort by IOSCO, the Basel Committee of Banking Supervisors, the European Commission, the Financial Stability Board, the International Association of Insurance Supervisors, and the World Bank. The advancement of the public interest in international audit standard-setting and audit quality is no small thing; and we remain convinced that the constant review of these standards must be carried by global authorities, as well as the occasional review of the governance of these processes.

This past November, the Monitoring Group launched a global public consultation,[1] due to close in early February, on the governance of audit standards. As we understand this consultation, the overarching concern is that the bodies establishing global audit and assurance standards may not be sufficiently independent of the accounting and audit professions, and therefore – perhaps – not responsive enough to the public good.

The two key questions raised in this consultation are whether there is an adverse effect on stakeholder confidence in these global standards, which form one of the building blocks of the Financial Stability Board compendium of standards covering all aspects of banking, insurance, and capital markets:

'…is there a perception of undue influence by the profession on two grounds:

a) IFAC, representing the global accountancy profession, manages the nomination process of the standards-setting boards, and directly funds, accommodates, and provides support and staffing for the standards-setting boards – IFAC itself is funded by member organizations and the global accountancy profession; and

b) Audit firms and professional accountancy bodies provide a majority of board members and their technical advisors.'

From this perception of possible undue influence by the accounting and audit profession that might undermine the public interest element of this work, the Monitoring Group is soliciting comments on whether the standards are somehow unbalanced given the breadth of audiences and their diverse needs from audited statements, as well as the risk that the standards produced are possibly less relevant and slower to adapt to the changing audit and business environment.

[1] Monitoring Group Consultation: 'Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Boards in the Public Interest,' posted by IOSCO and the other member agencies in November 2017.

The public comment asks if one agrees that these risks to independence and neutrality are real and significant, and goes on to propose several options for reform, as well as to invite other possible solutions.

The key principles the Monitoring Group wants audit standards-setting bodies to support and exemplify are:

- Independence
- Credibility
- Cost effectiveness
- Relevance
- Transparency
- Accountability

We could not endorse these objectives more strongly.

What is the problem?

The problem is simple enough to state; the answer, too, in theory: financial reporting standards are devilishly complex, full of jargon, intertwined with national tax codes, hard to agree at a global level and apply with reasonable consistency across local jurisdictions, in reality understood in their minutiae by very few experts. And yet they are supposed to uphold the public good in this critical area of our national economies, with enough comparability to ensure ease of reading these statements across borders. For better or worse, audited financial statements are the world's *lingua franca* of business; and as with any natural language, there are a large number of complex constructions.

Ideally, the public interest would be better represented by having more diverse groups of persons setting these standards, in order to balance out the potential for over-reliance on the insiders, the accounting firms and their senior managers, in these standards setting processes. That ideal runs into the very real problem, however, that persons outside the accounting world are ill equipped to wade through the jargon and get into the meaning and effect of each of these standards. They simply do not have enough experience of audit to decipher the detail without considerable assistance.

In the mid-2000s, the International Federation of Accountants ('IFAC') embarked on a multi-year project to clarify the international audit standards ('ISAs'). This did help. However the governance of the standards-setting process remains tilted towards insiders for reasons of providing sufficient expertise. The Clarity Project did not necessarily provide enough simplicity in what remains stubbornly detailed, complex material. In fairness to all involved, much of the complexity problem has to do with the changing nature of business where so much more is intangible.

The dilemma posed here is analogous to independent directors on corporate boards versus their colleagues who come from senior executive roles within the company, as they all try to guide the corporation forward.

What does the Monitoring Group suggest?

Currently, there are separate standards-setting oversight boards for the audit and assurance standards as well as the ethical standards underpinning the profession. Should these be merged? Should the separation be maintained? Or should the profession's global coordinating body, IFAC, be in charge only of education and ethics standards, but not audit?

Another question concerns the composition of these standards-setting bodies. Should quotas be set to assure that different stakeholder constituencies have a minimum of representation, supposing that the whole would more transparently assure the defence of the public good? How should candidates be identified? Should there be an open call? Should the candidates be vetted solely by the Public Interest Oversight Board in Madrid, as is proposed by the Monitoring Group? Given its mandate and the concern by the Monitoring Group, that might be the neatest solution to this knotty problem.

Comments on questions raised by the Monitoring Group

Question 3 – the test of whether the public good is met in any single standard is if the non-accounting and audit members of the standards setting body can readily and accurately summarize the key points in their own words.

Question 4 – we would support a single board for audit standards and the ethics of the profession, the more so because of existing overlap of members. If one can gain any efficiencies, that would be all to the good.

Question 6 – yes, IFAC should retain responsibility for educational standards. This does not mean that its work should not be overseen in this regard.

Question 7 – we believe the Monitoring Group should ask itself whether it must find the resources to cover more costs for standards-setting bodies and the consultative advisory group. Maybe the group sizes should be reduced somewhat, and perhaps interested persons not affiliated with any particular organization should be invited to join in recognition of their expertise and motivation. The volunteer character of this work has its advantages, but perhaps that has reached its limits, and service on these boards needs to be put on a par with service on corporate boards.

Question 8 – yes, we believe the members of the board should be remunerated in recognition of the serious responsibilities they assume.

Question 10 – the concept of split periods of service is novel for us, and we wonder if that might not split the sense of cohesion required for common decision-taking. As to diversity, the Monitoring Group is going to have to include various stakeholders, and perhaps add competent independent individuals.

Question 11 – the chief skill is commitment to subject and an ability to synthesize and summarize very complex material.

Question 12 – our view was that the CAG concept worked very well, and was taken very seriously by its members. Those nine years of service were a very satisfying part of my professional life, if I can use that criterion as a measure of the body's successful work.

Question 18 – some proportion of the Public Interest Oversight Board members should be independent, and these persons should be identified by an open call for candidates, including from beyond the Monitoring Group bodies.

Queston 19 – the Public Interest Oversight Board should oversee all the related standards-setting boards, because the subject matter is interconnected.

Question 21 – all these boards need expanded technical staff help, because that is the nature of the subject matter. One task for the technical staff would be to help synthesize the information, to make sure the public has a readily accessible summary of the main points and their impact on financial reporting. (For those who are especially keen, the approved, detailed documents should be available for reading, but that would not often be to meet a general public interest inquiry.)

Question 24 – to the extent that a permanent source of funding could be found and disbursed by a foundation, even for part of the budget, that should give a more neutral tone.

Question 27 – as a suggestion, could these boards have an independent lead member to work together with the chairman, much in the way that corporate boards have been defining the role of independent lead director?

Observations as a member of the IAASB Consultative Advisory Group

These thoughts are merely the observations of one individual, recalling meetings that took place more than a decade ago and trying to remember what the atmosphere was like.

The feeling I believe many of us had walking into those meeting rooms was one of very warm welcome. Care was taken to introduce new-comers respectfully, to make them feel part of the group. Each of us was always encouraged to speak up; and although most of the time I had rather little to say about some of the more arcane points, when I did have a remark I was carefully and respectfully listened to. The varied backgrounds brought differing perspectives, and the individuals came together as committed persons. We felt it was good work.

The meeting agendas were carefully prepared, and the documentation was circulated well in advance. It was extremely copious, and as a non-auditor I did find the subject detail intimidating. But the point of my participation was not to comment on those details, really, but rather to comment on some of the broader picture strategic value of the audit practice. Not being an expert in this sense was precisely the point: great effort was made to reach out to non-experts. During the presentations, the experts on particular material took extra care, to the extent they could, to break free of jargon and speak more simply than they would have if the group were audit experts only.

The preparation required for the meetings was considerable, as was reading through the detailed draft minutes afterwards. If memory serves, most advisory group members did their homework, several in impressive detail. The remarks given to the IAASB were well considered.

In my view, the CAG did not succeed enough in a few areas that mattered deeply to me. The first was the role of the junior auditor in the field, going through papers at the client's office, and the full moral and practical support of the office given to him/her. The level of persons setting audit policy is such that many have forgotten what those first hard years were like, and how difficult it is to make out what the company truly is doing and how that is reflected in the statements being audited. This is not a simple task. The question raised was whether sufficient resources were regularly allocated to mitigate this risk to the quality of the audit process.

A second question that seemed unsettled is whether Clarity went far enough in simplifying the public view of these audit standards. Too much simplification distorts, to be sure; equally, the right balance is always going to be hard. But the standards after Clarity still seem beyond the grasp of many or most non-professionals. The reason given was sensible enough, namely that each standard did require that level of detail in order to provide sufficient guidance to auditors; each standard had to speak to the audit professional.

The last question relates to one of the key policy problems for finance generally these past two decades, namely the growth and now the massive size of over-the-counter, bespoke derivatives and how they are to be valued. This question was raised repeatedly on the IAASB CAG between 2003-2005, n the context of signing accounts with significant doubt as to the value of these positions and their impact on balance sheets. The question was also shared with IOSCO and the International Accounting Standards Board; as they had been previously with the Basel Committee in late 2000, though not in the IAASB CAG context. The point was thought to be too hard, which many of us understood to mean simply too political and beyond the scope of the IAASB. One only had to recall France's President Jacques Chirac carving out the specific accounting principle for derivatives from IFRS when accepting the rest of that body of standards. One can only sense the reasons why some powerful players had a very great interest in keeping this line of business going in a less than transparent way – even after the collapse of these financial contracts proved to be a major cause of the 2007-2008 financial crises, the OTC derivatives business has continued to grow apace. If only the valuation question for auditors had been taken seriously, would 2007-2008 have hit so hard?

Were any of these disappointments due to the influence of the accounting and audit community on the work of standards-settings? How could one know?

In sum, of the board work experienced in my career, never was procedure so scrupulously considered and followed, nor was time better allowed to solicit all thoughts at every point in the agenda. CAG members also got feedback on what the IAASB thought about its work. We were made to feel welcome in the group, committed to its purposes, and encouraged to feel part of a larger project.

Conclusion

In our increasingly technical world, the insiders in every sector of the economy are regularly gaining an advantage over the majority, mostly unwittingly so and without attributing anything wrong. There is no suggestion that the audit standards-setting was in any way adversely influenced by the domination of accountants on those bodies; there is every sense that the Monitoring Group wishes to maintain absolute integrity in order to maintain the public's confidence in its work.

Given the high demands on agendas of the sort of professionals who can and should work through these meeting documents, and give considered time to the substance of audit and its directions and standards, too, there is probably little to be done in rebalancing participation. But perhaps the governance problem is not all that serious, after all, unless there has been a gradual change in the workings of these bodies since 2011.

Albert Einstein, who managed to simplify physics into general relativity, once said the following about how to conduct science: "Everything should be made as simple as possible, but not simpler." The same could be said of the content of audit standards as well as the governance of the standards-setting oversight. We may have to wait for another Einstein to tell us how to sort that out perfectly; but somewhat short of perfection, we would affirm with confidence that normal, committed individuals have not been doing such a bad job. If they were willing to accept mediocrity or giving into pressures of one kind or another, they would not be conducting this governance review.

With our sincere thanks,

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