

9 February 2018

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The Monitoring Group  
International Organisation of Securities Commissions  
C/Oquendo 12  
28006 Madrid  
Spain

Dear Sirs

**Monitoring Group consultation – Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Boards in the Public Interest**

We are pleased to respond to your invitation to comment on the above consultation. We have responded to the questions posed in the consultation paper in turn below, but also have some overall observations.

From our review of the consultation paper and attendance at the outreach event in London on 15 January, we are extremely concerned that the focus of the consultation – and by implication the focus of the Monitoring Group – is almost entirely on the audit of Public Interest Entities (PIEs). Whilst the systemic risk, and the impact of an audit failure, is clearly more significant in respect of such entities, the International Standards on Auditing (ISAs) need to be fit for purpose not only for large PIEs but also for the many owner managed, small and medium size entities which are subject to audit. There is no mention of proportionality whatsoever in the consultation paper and if proportionality is still considered – as it should be – to be a fundamental principle of better regulation then the concept has to be embedded not only in the standard setting process but in any reorganisation that follows this consultation.

Although we recognise that there are a number of jurisdictions, such as the United States, where companies that are not considered public interest do not require an audit, this is not the case in the United Kingdom, a number of member states of the European Union, or in many other countries around the globe. The Monitoring Group must not lose sight of this and we believe there is a significant risk that revisions to auditing standards, driven by the revised governance and oversight framework proposed in the consultation, will lead to the standards being disproportionate, or even unworkable, for the audits of smaller, particularly non PIE, entities with the costs to such entities also being disproportionate. Whilst some organisations, such as the Nordic Federation of Public Accountants, have proposed separate auditing standards for smaller entities we believe that the IAASB's approach to standard setting should be a 'bottom up' approach, with auditing standards being fit for purpose across the board with additional requirements for PIEs/ listed entities.

We also believe there is a significant risk under the proposed structure that the voice of the profession will be diluted to such an extent it will increase the risk that auditing standards become unworkable, overly rules-based and prescriptive. The proposed governance structure would be composed of representatives of the profession, preparers and users (most likely drawn from the

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investor community and regulators) with four representatives from each group and a majority needed for a decision to be reached. Whilst the consultation paper states this structure would ensure no one element could outvote the other, it would be entirely possible for preparers and users, working in concert, to ensure the representatives of the audit profession could be outvoted on any issue on which they chose to do so. This is quite simply unjust and we have explored this issue in more detail below.

Finally, and fundamentally, the entire consultation appears to be predicated on a presumption both of issues at IFAC (including lack of independence and therefore the quality of the ISAs) and of issues with the quality of audit as a whole. In our opinion there is no evidence whatsoever that there are fundamental flaws in the current standard setting model or in the standards themselves, or any evidence of a lack of independence within IFAC. The current standard setting model already has independent oversight, together with robust checks and balances in place to ensure that no single stakeholder can exercise undue influence over the standard setting process – but the new model would be highly likely to result in regulators being able to do so.

Whilst clearly there have been instances in recent years where the quality of individual audits has been found by regulators to have required improvement, there have been other issues of corporate failure where there has been no evidence that the auditors were in any way at fault. Equally, a failure to *apply* auditing standards appropriately does not mean that the standards themselves are not fit for purpose, including for audits of PIEs, or that the current structure of IFAC and the IAASB is in need of radical change. The case for what amounts to dismantling the current structure of IFAC is not, in our view, well made.

We do not disagree in any way that high-quality, robust and independent auditing is in the public interest, but are not convinced that the proposed revisions are in any way necessary in order to achieve it, nor that there is any significant issue at present which requires the proposed drastic intervention rather than an ongoing collaborative process of review and improvement.

**1. Do you agree with the key areas of concern identified with the current standard setting model? Are there additional concerns that the Monitoring Group should consider?**

We do not agree that there are issues regarding the independence of the standard setting process or that the influence of the profession is too strong. In our opinion this is a misperception rather than a fact and there is no evidence whatsoever that the ISAs, or the current standard setting process, are not fit for purpose. Indeed on page 8 of the Consultation Paper this concern is worded as 'The adverse effect on stakeholder confidence in the standards as a result of a *perception* of undue influence by the profession'. If, even the Monitoring Group considers that undue influence is a perception rather than a reality, as implied by the phrasing of the concern, then surely the action that needs to be taken is challenging this misperception - rather than radically restructuring the standard setting process, a task that will be time consuming, complex and expensive.

It follows on from this misperception that the risk that standards are not developed fully in the public interest is also a misperception. If standards were developed for other reasons – for instance to make life easier for the auditor – they would not be subject to the rigorous development and review process that they already currently undergo before being released. The standards are designed to ensure that, if they are followed, the result is a high quality audit and when this does not happen there is no evidence whatsoever that the standards themselves (or the standard setting process) is at fault.

We also do not agree that the development of standards is not sufficiently timely. We recognise that standards do take time to develop however this is not limited to auditing standards; recent International Financial Reporting Standards such as IFRS 15 'Revenue from Contracts with Customers' and IFRS 16 'Leases' have taken many years to develop. There is a balance to be struck between getting a standard done quickly and getting it right, and rush releasing auditing standards is unlikely to lead to improvements in audit quality. Indeed, it is far more likely to lead to standards being issued which do not represent any improvement on the previous standards, are based on rules rather than principles, are difficult to apply in practice, or are disproportionate to the audit of SMEs.

**2. Do you agree with the overarching and supporting principles as articulated? Are there additional principles which the Monitoring Group should consider and why?**

Whilst we have no particular issues with the supporting principles proposed in section 2 of the consultation paper, or the principle that standard setting must be sustainable in the long term, we do have concerns about how at least some of these principles may be interpreted in practice. In particular we are concerned about the prospect of stakeholders outside the profession being able to disregard the views of stakeholders within the profession due to the proposed composition of the Board, which we have explored further in our response to question 9.

We are concerned that the Monitoring Group risks disregarding the technical and practical experience of the profession – particularly in how standards work in practice – in favour of addressing a misperception of lack of independence and of the standard setting process being too slow. We are concerned that the Monitoring Group may feel that it needs to be seen to do something to address a perceived issue without demonstrating that such a huge change is actually warranted. In this, the cost effectiveness principle articulated in the consultation paper would seem to be breached as the significant cost of the proposed restructuring is in our view highly unlikely to outweigh any perceived benefits.

**3. Do you have other suggestions for inclusion in a framework for assessing whether a standard has been addressed to represent the public interest? If so what are they?**

Yes. As smaller non listed entities are still required to be audited in many jurisdictions the relevant standards also need to be able to be applied proportionately to such entities. It is not in the public interest for the audits of entities that are not PIEs to become unworkable because the standards are designed principally for the audits of PIEs. Audit still has a value to smaller entities but there is a risk that value will become eroded, or perceived to be, if the effect (and therefore the cost) of applying the standards is disproportionate. This will have particular detrimental effects on smaller entities which are required to have an audit due to legislative requirements, such as UK charities where the threshold is set at a much lower level than for non charitable entities.

As noted in our introductory remarks we are not in favour of separate auditing standards for smaller entities but rather a 'bottom up' approach where standards are initially designed for application by SMEs with additional requirements for listed/ PIE audits. However, if the development of auditing standards becomes increasingly focused on the audits of PIEs with the standards therefore becoming increasingly complex, it is easy to foresee a situation where separate auditing standards for smaller entities may become the only viable option. No economy wishes to deter business enterprise and growing business because of the disproportionate cost of an audit.

**4. Do you support establishing a single independent board, to develop and adapt auditing and assurance standards and ethical standards for auditors, or do you support the retention of separate boards for auditing and assurance and ethics?**

We are not convinced that the case for one combined board, or for a separate board to set standards for professional accountants in business, has been convincingly made. We therefore do not agree with this proposal.

We would note that audit and assurance standards, as currently developed by IFAC, are not limited to auditing standards. They encompass standards on assurance engagements, and standards on related services for instance 'agreed upon procedures' engagements. These are not referred to in the consultation paper but are an important part of IFAC's work, particularly for SMEs who in some jurisdictions may be far more likely to be subject to a limited assurance or agreed upon procedures engagement than an audit. It is vital that these standards do not fall by the wayside as a result of any wholesale restructuring.

In our view, one board should be responsible for auditing, assurance and related standards and another should be responsible for ethics, including ethical standards for professional accountants in business. There is no reason why two separate boards would not be able to work closely together or why having two separate boards affects the embedding of ethics within everything the auditor does (with which we entirely agree). We believe a single board would have far too wide a remit and there would be too great a constraint on resources as it would simply have to handle too much.

Furthermore, we do not believe that the ethical bar for professional accountants in business should be set any lower than for auditors and therefore the same board should be responsible for both. An accountant who is preparing the financial statements for a PIE should be – and be expected to be – just as ethical as the accountant who is auditing that entity's financial statements. Indeed if they are not this can only lead to conflict in the auditing process.

Our views in respect of proportionality apply equally to ethical standards as to auditing standards. What may be appropriate for a PIE (e.g. prohibition of the provision of many non-audit services by the auditor) is often neither necessary nor appropriate for an SME and we are concerned that this distinction could be lost if the revised structure comes into effect and there is too much focus on standards simply from the perspective of PIEs.

**5. Do you agree that responsibility for the development and adoption of educational standards and the IFAC compliance programme should remain a responsibility of IFAC? If not why not?**

In the event the proposed structure is put in place then we would agree this should remain the responsibility of IFAC, but as made clear elsewhere in this letter we do not believe that the drastic change to IFAC's remit is either desirable or necessary.

**6. Should IFAC retain responsibility for the development of ethical standards for professional accountants in business?**

Please see our responses to the above questions.

**7. Do you believe the Monitoring Group should consider any further options for reform in relation to the organisation of the standard setting boards?**

Not other than as noted above.

**8. Do you agree that the focus of the board should be more strategic in nature? Do you agree that the members of the board should be remunerated?**

The role of the standard setting boards is to ensure the development of high quality and proportionate auditing, assurance, ethical and related standards, and providing related guidance and outreach. The 'strategy' of the boards is therefore to ensure that the standards they develop are fit for this purpose, ensuring that they are kept up to date and that they remain responsive to key issues such as the increasing use of data analytics as well as developments in the market and, where appropriate, issues identified with the conduct of audits. We believe that IFAC is already following such a strategy.

The time commitment for a board member is significant and we can therefore see some argument for board members being remunerated, although there is a counter argument that the voluntary nature of the boards at present means that it is only those individuals who are truly committed to developing high quality audit, assurance and ethical standards are prepared to serve on the board, given there is no question of any financial gain. Overall we would favour unpaid members.

**9. Do you agree that the board should adopt standards on the basis of a majority?**

We do not see any need for absolute unanimity when adopting standards however we believe more than a simple majority is needed. As noted in our introductory remarks, the proposed structure – where the composition of a board of 12 is drawn equally from auditors, preparers and users of financial statements – means it would be all too easy for the representatives of the audit profession simply to be outvoted. In our view, the ability of the profession to input to the standard setting process, not simply at a technical development level but at the highest level, is essential to ensure that standards are not only technically robust but actually work in practice. Knowledge and experience of applying such standards is vital to ensure that they are both workable and proportionate and whilst both preparers and users may have relevant experience at some time in the past, it is not generally current.

Given the Chair will presumably not have a casting vote, we also do not see why the Chair should be prohibited from coming from a practitioner background. This again implies that the Monitoring Group believes the views of the profession should not be given as much weight as those of other stakeholders.

At present, the structure of each standard setting board is that it comprises 18 members comprising both practitioners and non-practitioners. No more than nine members can be practitioners. Under the present structure it is therefore not possible for practitioners to force through a standard against the wishes of non practitioners (or indeed the reverse) which appears to us to be reasonable. The proposed new structure gives non practitioners the ability to impose on practitioners standards which may be unworkable in practice or disproportionate and practitioners would be unable to do anything to prevent this. Such a situation is not only undesirable but frankly unjust and surely is not necessary to address misperceptions of a lack of independence at board level. Rather, as noted in our introductory remarks, these misperceptions should be addressed.

In the event that the proposals for board composition proceed we would strongly suggest that a standard can only be approved when both there is majority approval and at least two members of each stakeholder group are in favour. This would mean that the representatives of the audit profession could not outvote users and preparers but nor would the reverse be true. This would be a far fairer solution whilst still addressing the misperceptions of a lack of independence.

**10. Do you agree with changing the composition of the board to no fewer than twelve (or a larger number of) members; allowing both full time (one quarter) and part time members? Or do you propose an alternative model? Are there any other stakeholder groups that should also be included in the board membership, and are there any other factors that the Monitoring Group should take account of to ensure that the board has appropriate diversity and is representative of stakeholders?**

We have no particular views on the number of board members (as opposed to our concerns in respect of composition of the board as set out above) but reiterate that a single board would have too broad a remit and this could be particularly pronounced if the number of board members was significantly reduced.

If the proportion of representatives of the profession is significantly reduced as proposed (from half to one third) then a further concern is that the ability of medium size and smaller firms to become involved would be significantly reduced. If the focus of the board or boards is increasingly on the application of auditing and ethical standards to PIEs, it is highly likely that the non practitioner board members will expect the representatives of the profession to be drawn from the very largest firms, increasing further the risk that the resulting standards will not be able to be applied proportionately to the audits of smaller entities. With four members from the profession the board representation is likely to be dominated solely by the Big Four firms which is not a fair or balanced representation of the audit market place.

**11. What skills or attributes should the Monitoring Group require of board members?**

Strong technical skills and familiarity with the relevant standards are vital to ensure that the relating standards are both technically robust and capable of being applied in practice.

**12. Do you agree to retain the concept of a CAG with the current role and focus, or should its remit and membership be changed, and if so, how?**

We do not see any particular reason to change the remit and membership of the CAG and indeed if the proposed restructuring does proceed the need for consultation will become more important rather than less.

**13. Do you agree that task forces used to undertake detailed development work should adhere to the public interest framework?**

Yes, we would agree this is appropriate subject to our caveats above regarding how the framework would be applied in practice.

**14. Do you agree with the changes proposed to the nomination process?**

We do not believe that there are any issues with the current nomination process. It should continue to be conducted via an open call for candidates.

**15. Do you agree with the role and responsibilities of the PIOB as set out in this consultation? Should the PIOB be able to veto the adoption of a standard, or challenge the technical judgements made by the board in developing or revising standards? Are there further responsibilities that should be assigned to the PIOB to ensure that standards are set in the public interest?**

Whilst we agree that the point of the PIOB should be to protect the public interest in the adoption of standards, as indeed is its role at the moment, and we agree that it should provide regular feedback to the standard setting boards (which might conceivably include challenge to technical judgements made) we do not believe that it should have a right of veto. Given the level of input into standards development by a variety of stakeholders this will simply not be required and could be viewed as another nuclear option to restrict the input of practitioners into the standards that they are required to apply.

**16. Do you agree with the option to remove IFAC representation from the PIOB?**

No, we do not agree with this option. Having one IFAC representative on the PIOB does not, in our opinion, mean that it would automatically not be independent. For the reasons noted in a number of our responses it is vital that the technical capability and experience of the profession is represented at all levels.

**17. Do you have suggestions regarding the composition of the PIOB to ensure that it is representative of non-practitioner stakeholders, and what skills and attributes should members of the PIOB be required to have?**

As in our response to previous questions we believe that sufficient understanding of standards and how they are applied is vital to ensure the resulting standards are proportionate and fit for purpose.

**18. Do you believe that PIOB members should continue to be appointed through individual Monitoring Group members or should PIOB members be identified through an open call for nominations from within MG organisations, or do you have other suggestions regarding the nomination/ appointment process?**

Having an open call for nominations would be consistent with the procedure for nominating members of the standard setting boards.

**19. Should PIOB oversight focus only on the independent standard setting board for auditing and assurance standards and ethical standards for auditors, or should it continue to oversee the work of other standard-setting boards (e.g. issuing educational standards and ethical standards for professional accountants in business) where they set standards in the public interest?**

We do not see any reason to change the remit of PIOB oversight and it should therefore still include ethical standards for professional accountants in business and educational standards. However, as should be evident from our previous responses, we do not agree with the proposed restructuring, for the reasons we have set out throughout this response.

**20. Do you agree that the Monitoring Group should retain its current oversight role for the whole standard setting and oversight process including monitoring the implementation and effectiveness of reforms, appointing PIOB members and monitoring its work, promoting high quality standards and supporting public accountability?**

Yes, we agree with this, although subject to our concerns raised in various responses.

**21. Do you agree with the option to support the work of the standard setting board with an expanded professional technical staff? Are there specific skills that a new standard setting board should look to acquire?**

In the event that the proposed restructuring does take place we think that an expanded professional technical staff is vital to ensure the technical robustness of standards. We remain concerned that the proposed structure would place a perception of the public interest ahead of the technical robustness and practical effectiveness of the standards, particularly in respect of application to smaller entities.

**22. Do you agree that permanent staff should be directly employed by the Board?**

In the event the proposed restructuring goes ahead then we agree that this would be appropriate (and indeed would be the only realistic option).

**23. Are there other areas in which the Board could make process improvements – if so what are they?**

We do not have any other suggestions although we reiterate our concerns about the proposals to speed up the standard setting process and that this might compromise the quality of the resulting standards.

**24. Do you agree with the Monitoring Group that appropriate checks and balances can be put in place to mitigate any risks to the independence of the board as a result of it being funded in part by audit firms or the accountancy profession?**

We believe any risks could be mitigated, for instance by independent approval of the budget, although we believe that in reality any risks arising from such funding arrangements would be minimal. However we believe that questions of funding are premature and should be addressed once the final form of any revised structure is known.

**25. Do you support the application of a contractual levy on the profession to fund the board and the PIOB? Over what period should the levy be set? Should the Monitoring Group consider any additional funding mechanisms, beyond those in the paper, and if so what are they?**

We do not believe that the fact that IFAC is funded by contributions from its members creates any real risk of undue influence over the standard setting process. This is, once again, a perceived rather than an actual issue.



Under the proposed structure the board, and the technical staff required to support it, would obviously need to be funded in some way however in our view the funding should be drawn from a wider variety of sources than just the profession. To fund the structure via a contractual levy on the audit profession, when the proposals include a board structure which gives preparers and users (if acting in concert) the ability to impose standards on the profession without its agreement, seems to us to be entirely inequitable. We are also unclear how such an arrangement would address the misperception of undue influence from the profession – or what basis there would be for such a levy and which firms the levy would be applied to. This is not discussed at all in the consultation paper.

Essentially, any such levy is a regulatory fee and logically it should therefore be paid by the entities that are subject to audit as part of their regulatory regime. This would actually reduce the cost of audit as the audit profession would not need to cover the costs of increased regulation – possibly falling solely or substantially on the profession - via increased fees. There is also an argument to extend the levy more widely for instance to stock exchanges, investor bodies and national regulators all of which stand to benefit from the development of high quality international auditing and ethical standards.

**26. In your view, are there any matters that the Monitoring Group should consider in implementation of the reforms?**

As should be clear from our responses, we do not agree with the proposed reforms. We do not believe that reforms of this magnitude are required to address what is a perceived rather than an actual issue and do not believe that the case for the reforms has been convincingly made. As noted in our introductory remarks, to undertake what amounts to a dismantling of a structure that has worked, and still is working, well in practice seems to us to be a sledgehammer to crack a nut. If the Monitoring Group believes reforms are necessary we would recommend a gradual process of improvement rather than rushing through wholesale major changes as a result of misperceptions.

We also urge the Monitoring Group to consider the need for proportionality when developing standards; as noted throughout our response, auditing and ethical standards need to be capable of being applied to the audits of small and medium sized entities and not just the audits of larger public interest entities where the systemic risk is greatest.

**27. Do you have any further comments or suggestions to make that the Monitoring Group should consider?**

Our understanding from attending the outreach event is that the Monitoring Group wishes to move quickly to implement the reforms. This very much gave the impression of the reforms being a 'done deal' with the monitoring group having already decided on its course of action regardless of the responses to the consultation. The phrasing of a number of the questions in the consultation paper gives the same impression.

We trust that this is not the case and that the Monitoring Group will take on board the responses to the consultation from all stakeholders, including the audit profession and IFAC itself, and will take the time to ensure that any reforms are implemented with the least possible disruption to the standard setting process with the consequent risk of such disruption to the quality of the standards under development.

We trust that our comments are useful to you. If you have any questions on our response, then please contact Tessa Park.

Yours faithfully



**Kingston Smith LLP**