

Our ref: TMM/AT
Your ref:

The Monitoring Group
IOSCO
Oquendo 12
28006 Madrid
Spain

12 March 2018

Dear Sirs

Response on behalf of Group A and APA firms¹ to IOSCO's Monitoring Group's Consultation on *Strengthening the Governance and Oversight of the International Audit-related standard-setting Board in the Public Interest*

Introduction

The firms within Group A and APA which represent a significant proportion of the accountancy profession in the UK welcome the opportunity to comment on the above consultation.

The importance of proportionality

A number of the Group A and APA firms have audit clients which are public interest entities but a large number of their audit clients are privately held businesses and public benefit entities. As a result, this response emphasises the need for proportionality in the system for the setting of audit and ethics standards at an international level.

Proportionality is the check and balance on the content and implementation of regulation that ensures that it serves, in the least burdensome way possible, the interests of those upon whom it impacts – our particular focus in this respect is the SME sector: it is very much in the public interest for regulation to allow SMEs to achieve sustainable success with fair and balanced regulation that is not unduly burdensome – the wellbeing of this sector is, by common consent, vital for the growth of economies of every size and sophistication and for employment in them.

Need to have regard to the audit environment

We believe it is very important that the review of governance being undertaken have regard to the significant issues related to the function and scope of audit, which are currently the subject of much discussion, if it is to create a standard-setting system that is capable of meeting current challenges and those likely to be faced in the years ahead. These include for example a range of matters related to the impact of technology on audit.

Essential to secure the support of all main stakeholders

Recognising that the standard-setting process needs to command the widespread confidence of all its main stakeholders, in charting the way forward, we would stress the importance of acknowledging the achievements of the current system to date and maintaining those key elements of it which have contributed to the progress made in the setting of international standards on auditing and ethics to date.

¹ **Group A** - Crowe Clark Whitehill, Haines Watts, Kingston Smith, Mazars, Moore Stephens, RSM, Saffery Champness, and Smith & Williamson; **APA** – Armstrong Watson, BHP, Blick Rothenberg, Brebners, Buzzacott, Dixon Wilson, Duncan & Toplis, James Cowper Kreston, Kreston Reeves, Mercer & Hole, Price Bailey, Roffe Swayne, and Shipleys.

In particular, we consider that the broad-based acceptance of proposed changes by all the main stakeholders will play a vital role in their successful implementation and the consultation process should seek to secure this support.

It is important to bear in mind in any reforms that IFAC has become a global standard setter with the status to overcome the reality that the adoption of standards and compliance with them cannot simply be mandated. It is dependent on voluntary adoption of its standards – whether at a jurisdiction or audit firm or network level. Auditors and other stakeholders related to the profession and civil society, as well as very importantly regulators and institutional investors, also need to have confidence in the global standard setting system for it to succeed.

Support for separate audit and ethics standard-setting bodies

With the above paragraph in mind, we support the retention of two standard-setting bodies, one for audit and one for ethics, with their current remit, ie the audit body covering the setting of standards for PIE and other audits and the ethics body considering ethics across the profession.

General comment on response

Some of the firms are members of major international networks and it is possible that this collective response may contain some variation in opinion from those expressed by or on behalf of those networks. This response is predicated on how the proposed changes may impact the auditing environment within the UK in particular and the differing landscape for audit across jurisdictions may result in a range of view within those networks.

Yours sincerely



T M McMorrow
Secretary to Group A
on behalf of Group A and APA

Appendix 1 Detailed responses to the individual consultation questions

1. Do you agree with key areas of concern identified with the current standards-setting model? Are there additional concerns that the MG should consider?

We fully agree that auditing and ethics standards should be, and be seen to be, fully developed in the public interest and that the profession should not, or be perceived to be, dominating the standard-setting process.

The proposals note the importance of multi-stakeholder involvement which we strongly support and the diverse involvement of the profession helps ensure broad stakeholder acceptance of the standards. Audit regulators' and institutional investors' primary focus on capital markets and listed entities is complemented and supplemented by the needs of those in the SME sector and, more broadly, national economies around the world.

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

We support the overarching and supporting principles. However, we believe that the description of the "relevant" principle should also include the need to develop standards that are capable of practical implementation as regards audits and assurance engagements for all entities, including small and medium-sized ones, and private ones as well as those with a listing on a stock market. We believe the public interest calls for international standards on auditing and ethics that take into account the needs of the different types of entities mentioned above. Entities, whether listed ones, other PIEs or private ones, vary in size and in the complexity associated with their financial reporting (in the same way as there are small, non-complex listed entities, there are also large, complex, private ones) though generally the needs and expectations of users of private-entity financial statements are significantly different from those of listed or other PIEs.

The audit offers public benefit in respect of all entities and it, along with the single set of auditing standards that we advocate, should be scalable based on the size and complexity of the given entity and taking account of the needs and expectations of the likely users of that entity's financial statements. There may therefore need to be significant differences in the core requirements of an audit in relation to different kinds of entities to support obtaining reasonable assurance that the financial statements are fairly stated.

We do not consider that retention of the current approach, whereby there is one set of standards with additional, scalable provisions that are applicable according to size of entity and whether it is a PIE or private entity, will have a significant negative impact on the credibility of the international auditing standards and auditing generally, assuming that the relative degree of inherent complexity of the entity is factored in. It follows from this that SME stakeholders, like others, should be fairly represented in the standard-setting process for auditing and ethics standards.

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

Proportionate regulation, which we regard as very important, involves taking a contextual view of (i) what the public interest is (ii) who the affected public are, (iii) factoring in what they legitimately should expect, (iv) how a balanced scorecard of competing interests is to be kept, and (v) how all these factors should influence the process by which final standards are arrived at. PIEs and SMEs each represent a significant proportion of commercial activity in most countries' economies and the essential purpose of auditing standards is to help bring about a sustainable economy through confidence in financial reporting across the breadth of corporate activity, private and public.

We also note that the PIOB is currently revising its own framework and this process should be allowed to conclude before any restructuring takes place.

4. Do you support establishing a single independent board, to develop and adopt auditing and assurance standards and ethical standards for auditors, or do you suggest the retention of separate boards for auditing and assurance and ethics? Please explain your reasoning.

We believe there should be one body for auditing and assurance standards and one for ethics standards each having a similar scope to that of the two current bodies. As discussed in our covering letter, our view is based on the view that the public interest extends beyond individual PIEs. We also believe it is important in the public interest to ensure a common approach to ethics standards across the profession.

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?

Yes we do.

6. Should IFAC retain responsibility for the development and adoption of ethical standards for professional accountants in business? Please explain your reasoning.

As discussed above, we believe there should continue to be a single body responsible for the setting of ethics standards both for audit and assurance providers and other accountants including those in business. As auditors are within its scope, most members of Group A consider the body should be independent of IFAC.

7. Do you believe the Monitoring Group should consider any further options for reform in relation to the organisation of the standard-setting boards? If so please set these out in your response along with your rationale.

Our main proposals in relation to standards-setting in auditing and ethics are set out above..

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

We see merit in the boards having a clear strategy for directing their work.

Most members of Group A would support appropriate remuneration for the chair and other members but this is naturally dependent on the necessary funding being secured and, apart from the chair, it would be expected that other positions would be part-time..

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

As the consultation paper says, this proposal is intended to address concerns about the timeliness of standard-setting, and to prevent one bloc of opinion unduly delaying the approval of standards.

We are not supportive of standards only requiring a simple majority to be passed but we would, however, support qualified majority approval of standards by say two thirds or three quarters of board members.

We would, however, have concerns if standards were able to be approved which were impractical to implement in practice because the votes of auditors were not sufficient to prevent this happening.

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 (three quarters?) members? Or do you propose an alternative model? Are there other stakeholder groups that should also be included in the board memberships, and are there any other factors that the MG should take account of to ensure that the board has appropriate diversity and is representative of stakeholders?

We would not propose regulators being board members just as they are not board members of IASB.

We believe that at least one third of board members should be user representatives such as investors and at least one third, but less than half, should have auditing experience. The remainder should come from other constituencies such as preparers, members of the academic community with an interest in the area or internal auditors.

At present, the structure of each standard setting board is that it comprises 18 members, both practitioners and non-practitioners and 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 an appropriate check and balance against bloc-voting and we believe this approach should be maintained within the context of our earlier comments on proposed voting structures.

The proposed membership and voting structure would give non-practitioners the ability to vote through a standard without any support from practitioners which may give rise in practice in particular circumstances to issues relating to the general acceptability of standards. Such a situation would not we believe be desirable and would not be in accord with the principles of better regulation.

In the event that the proposals for board composition and simple majority voting are accepted, we would strongly suggest that a given standard should only be able to be approved on a dual-test: when there is majority approval and there is approval by at least two members of each stakeholder group. This would mean that the representatives of the audit profession could not outvote users and others but the reverse would be true too.

We again make the point that, as a matter of jurisprudence, there should be separation of the functions of setting, oversight and enforcement of laws, regulations and also standards. If appointing nominees from the regulatory community, it will be very important to ensure that the inclusion in standards-setting boards of members from bodies whose role is of an oversight nature, does not undermine the separation of function point.

11 What skills or attributes should the MG require of Board members?

The key must be to achieve a wide range of skills, attributes and experience and thus diverse input from different board members. The board as a whole will need to understand the needs and constraints of stakeholder groups including having experience of undertaking, and being subject to, audits along with that of regulators and of professional bodies with regards to how standards have been applied. Experience of balancing these sometimes competing perspectives to arrive at the best outcome will also be important..

Even if the number of representatives of the profession is reduced as proposed (from half to one third) it remains essential for those from medium size and smaller firms, as well as the largest, to be involved in the standard-setting process to ensure that the opinions of different firms are taken account of in a fair way and that the resulting standards are able to be applied proportionately to the audits of the range of entities that exist.

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?

The current Consultative Advisory Groups contribute significantly to proposals as they evolve. They are, though, currently largely regulator-dominated membership and it will be beneficial to reflect stakeholders more widely in the CAGs going forward.

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

Adhering to the public interest framework is plainly critical and the task forces' duties in this respect should mirror those of the board.

14 Do you agree with the changes proposed to the nominations process?

Most members of Group A agree that the nominations and appointment process should be under the auspices of PIOB and be, and seen to be, independent of the profession. There will need, however, to be clarity on the enhanced role and new governance arrangements for the PIOB and the skills and expertise required on it.

To ensure transparency, we believe there generally should be an open call for candidates when appointments are being made but there may be circumstances where a search process, instead of or alongside, an open call is thought to be the best way forward.

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?

The proposed functions generally seem reasonable though the funding model needs to be determined. It will be important for the PIOB to be able demonstrate that its work in overseeing the standard-setting process is fulfilling the public interest, We do not consider that it should have the power of veto over individual standards or to intervene directly in relation to individual technical judgements.

As the PIOB is an oversight body, it should be clearly separate from standards-setting, but keep the work of the board and its task forces' under scrutiny and raise issues on a timely basis to avoid last minute concerns arising.

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

No, we do not agree with this option: the consequence of having one IFAC representative on the PIOB, who should not be the chair and may be non-voting, does not in our opinion mean a loss of independence.

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?

The PIOB's own composition should primarily reflect those relying on audited financial statements such as shareholders, including institutional investors, though it could include those representing employee interests, representatives of civil society and those who were previously regulators, Wide ranging input is important to ensure buy in and acceptance of both the process and the resultant standards.

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?

We believe that it would be appropriate for appointment to be made by the Monitoring Group as a whole, possibly via an open call for nominations (within the framework referred to above), rather than the current process where appointments are made by individual MG members. We consider this is more likely to achieve a balanced and diverse PIOB.

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?

The PIOB currently oversees standards-setting for all accountants, and, as discussed above, we believe it should continue to do so: having the most appropriate people with the necessary competencies and a sound

grasp of proportionality as well as technical accounting/auditing skills, is essential to achieving high audit quality in the public interest.

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?

It is important for there to be a strand of governance that has oversight of the whole process. The MG's role should extend to oversight of the appointments to PIOB and be mindful that the public interest encompasses but is a concept wider than those embodied in the perspectives of regulators and institutional investors alone which primarily focus on listed entities and other PIEs.

We also believe that fundamental questions, such as the purpose and scope of audit and how the expectation gap can best be addressed, are priority issues for the auditing and ethics standard-setting system to address as well as care being taken to ensure the most appropriate structure and process is in place. It is only through tackling all these issues that there will be high levels of confidence in audits and issues related to the profession's ethics.

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?

We recognise that some increase in the professional technical staff is likely to be needed subject of the necessary funding being available.

Staff members need to be skilled at communicating highly technical matters in an understandable way, allowing for not merely comprehension, but discussion and sound decision-making too which also involves being equally skilled in the framing of standards.

The auditing profession is about to enter a phase of profound uncertainty, and also opportunity, as it seeks to understand the use for new technologies, such as AI, and how they may best be deployed. Staffing considerations should be undertaken with these points in mind.

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

We support the permanent staff being directly employed by the Board and all staff engaged on the work of the board should report to it.

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

Process is important where its adoption favourably impacts audit quality. We believe that consideration should be given to how best to improve communication with stakeholders, encouraging engagement in real time. The overall effect of the proposed changes on quality, and the implementation issues related to them for auditors and other accountants should also be considered.

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?

In our view, broadening the funding model, just as it has been in the case of the IFRS Foundation model, would help address the independence risk/perception issue though we do not believe that the current funding model has resulted in financial pressure being brought to bear in practice on the setting of standards.

25 Do you support the application of a contractual levy on the profession to fund the board and the IOB? 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 are not persuaded of the merits of a contractual levy on the profession but would support agreeing of funding on say a three or four year basis.

We support a review of funding on the grounds of equity and to avoid perceptions, whether reasonable or not, that the profession may have undue influence over the standard-setting process. In this regard, any levy should logically be paid by the entities that are subject to audit as part of their regulatory regime. It should also be considered whether other stakeholders, eg stock exchanges, investor bodies and national regulators, should, as beneficiaries, make an appropriate contribution to the costs of the development of high quality international auditing and ethics standards.

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

We look forward to the MG's more detailed proposals including with regard to issues discussed in our response on how the new arrangements will work in practice. An impact analysis and a note of transitional arrangements should also be prepared.

We also urge the Monitoring Group to consider the need for proportionality when developing standards; as noted throughout our response: auditing and ethics standards need to be capable of being applied to the audits of small and medium sized entities as well as those 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 in London is that the Monitoring Group wishes to move quickly to implement the reforms. We very much hope that there will be full and open consultation on the proposed reforms and appropriate amendments made in the light of comments received. We believe buy-in from all the main stakeholders involved in audit and ethics standards-setting at an international level is vitally important to the system's sustainable success.