



The Monitoring Group
By email: MG2017consultation@iosco.org

09 February 2018

Re: Monitoring Group Consultation – strengthening the governance and oversight of the international audit-related standard-setting boards in the public interest.

Sarasin and Partners LLP is a London-based fund manager investing globally on behalf of charities, institutional investors and private clients. Our goal is to deliver sustained investment returns through an active long-term investment approach, which emphasises stewardship.

We welcome the Monitoring Group's consultation and the objective to strengthen the governance framework for auditing standards in the public interest. Healthy financial markets depend upon a system of accounting and audit which ensures full transparency and promotes effective stewardship. This enables providers of capital to monitor whether their capital has been protected, and whether company management teams have delivered enduring value.

We have deep concerns about the influence of the audit and accounting profession on the standard-setting and enforcement processes, and believe that reform is necessary to restore trust and avert a crisis of confidence in audit. We agree with many of the proposals outlined in the consultation and, in addition to direct feedback on the questions it poses, we draw attention to related concerns around conflicts of interest that weaken accounting standard setting by the International Accounting Standards Board, and we would welcome the Monitoring Group extending its review to cover this.

We would be very happy to elaborate on any of our responses of the matters we raise below.

Yours faithfully,

Natasha Landell-Mills
Head of Stewardship

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 share concerns that the current model gives the audit profession excessive influence over the standard-setting process, and we agree with the Monitoring Group's assessment that addressing this will strengthen public confidence in audit.

Our concerns arise principally from the fact that IFAC, representing and funded by the global accountancy profession, manages the nomination process for the standard-setting boards, as well as funding, accommodating and providing support and staffing to them. We also share the concern that audit firms and professional accountancy bodies provide a majority of board members and their technical advisors.

We believe that the influence held by the profession calls into question whether standards are being developed in the public interest.

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

We support the overarching principle that standards should be set and perceived to be set in the public interest. We also broadly agree with the supporting principles. However, regarding the requirement that no individual stakeholder should be able to exert undue influence over the standard-setting process, we would point out that audit ultimately serves the needs of investors (both equity and credit) and therefore this group's views should be given the greatest weight.

It is worth also being clear about which type of investor should be represented. We would argue strongly in favour of long-term investors and asset owners like pension schemes, and caution against reliance on sell-side analysts who may not be aligned with promoting long-term stewardship within companies.

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

The purpose of audit is to give providers of capital assurance around the reliability of companies' accounts. This is a vital foundation for efficient capital markets, and thus effective capital allocation within an economy. Where the accounts are not reliable capital will potentially be misallocated and economic growth and public welfare harmed. As the main users of these accounts, investor confidence underpins this broader societal function.

The key for long-term investors (both equity and credit) is knowing their capital is protected. Capital protection forms a key part of company law frameworks in most

jurisdictions. We would argue, therefore, that the audit standard framework acknowledge this vital goal, and ensure that no audit standard in anyway undermines its achievement. Critically, to ensure capital is protected we believe the auditors should always act with a prudent mind-set to ensure that the accounts they audit are not at risk of overstating either performance or capital. We do not believe a neutral approach serves long-term investor needs.

- 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 support the retention of separate boards for auditing and assurance and ethics? Please explain your reasoning.**

We support the creation of a single independent board with responsibility for international auditing and assurance standards and ethical standards. We share the belief that ethics and integrity must be embedded in everything the auditor does. It will be crucial to ensure sufficient expertise and focus on ethics is retained under such a structure.

- 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?**

We accept that educational standards for accountants in business may continue to sit most appropriately with professional bodies. However, we do not think that IFAC should retain responsibility for ensuring that its member bodies consistently and correctly adopt and apply the global standards. The fact that IFAC is funded by and ultimately represents the professional bodies and firms presents, in our view, a conflict of interest. Any monitoring of compliance must be independent of the profession which is being assessed.

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

We believe that the setting of ethical standards for professional accountants in business should be included in the remit of a new single and independent board rather than IFAC. Ethical behaviour and commitment to the public interest should be equally important for accountants in business who are preparing financial statements for audit, and so we do not believe there is a case for keeping these distinct and under the oversight of the profession itself.

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

We have no further comments.

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 support a more strategic focus for the board and we agree that members should be remunerated. This will help to attract candidates from outside the audit profession and reduce the reliance on practitioners who are funded by it.

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

We agree with the proposal that standards may be adopted on the basis of a majority vote, although the threshold may need to be higher than a simple majority. In particular, we believe approval should be conditional upon majority support from members who are independent of IFAC and the audit profession, to promote alignment with the public interest and mitigate the risk of conflicts of interest.

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 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?

The proposal for a multi-stakeholder board of 12 members is preferable to the current size of 18. However, we do not believe that it is necessary for auditors to be represented in equal proportion to regulators and “users”. Indeed, we would argue for auditors – or those with commercial links to audit firms – participation be limited to just 1 or 2 appointments.

The key stakeholders whose interests are at stake are the long-term providers of capital, and this group should ideally represent a majority of the board. We would also look also for independent experts from, for instance academia, alongside regulators. Finally, we would believe the Chair of the board should be reserved for a long-term investor representative.

To ensure sufficient number of investor, academic and regulator representatives come forward, remunerated roles should therefore be prioritised.

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

Board members should have an independent approach to standard-setting and overarching commitment to the public interest. Overall, there should be a requisite level of technical expertise although this should not lead to excessive reliance on practitioners.

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 agree with the ongoing role of Consultative Advisory Groups in providing advice to the board. Again, these should reflect a balanced range of interests, with investors forming the majority. The appointment process should be transparent and continue to be overseen by the PIOB to ensure members are committed to the public interest objective of standard-setting.

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

Yes, this should underpin all aspects of the standard-setting process.

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

Yes. The nomination process should be administered by the PIOB in order to remove undue influence over the board by the audit profession. IFAC should no longer play a role in appointing board members to oversee standard-setting.

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?

We support the functions outlined for the PIOB in the consultation, and would welcome the PIOB having powers to veto standard adoption or the ability to require remedial measures to be taken in the public interest.

It has been suggested that the scope of the consultation could in time extend to accounting standard-setting, and we would welcome this. There are vital public interest considerations in relation to accounting as well as auditing standards, and similar, if not more urgent, concerns about the excessive influence of the accounting profession in their development. We are concerned that the governing structure of IFRS is too closely linked to the profession and should ultimately be subject to similar public interest oversight, potentially under The Monitoring Group.

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

Yes, the PIOB should be wholly independent of the auditing profession.

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 should include significant representation of long-term investors, on whose behalf audits are undertaken. It should not include any current or recently serving audit practitioner, IFAC appointee or individual with material links to the audit industry.

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

To facilitate the appointment of investor representatives and to ensure the appointment of candidates with sufficient independence of thought, we would be supportive of an open call for nominations from within Monitoring Group organisations rather than direct nominations by individual members.

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 believe that the PIOB should oversee all standard-setting boards. Ethical behaviour and commitment to the public interest are of equal importance for accountants in business who are preparing financial statements for audit, and so we do not believe there is a case for keeping these distinct and under the oversight of the profession itself.

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.

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?

The current model of reliance on technical and logistical support provided by audit firms and professional accountancy bodies is problematic. It introduces conflicts of interest into the standard setting process and gives the profession excessive and non-transparent influence which may undermine the public interest.

We therefore support the proposal to move towards a self-supported staffing model for the standard-setting board, independent of IFAC and its member firms. While we

recognise this will involve transitional arrangements in the near-term, the staff structure should not rely on secondments from the audit firms and professional bodies.

22. Do you agree the permanent staff should be directly employed by the board?

Yes, it should be employed and funded by the independent board rather than IFAC.

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

We have no further comments.

24. Do you agree with the Monitoring Group that appropriate checks and balances can be put in place to mitigate any risk to the independence of the board as a result of it being funded in part by audit firms or the accountancy profession (e.g. independent approval of the budget by the PIOB, providing the funds to a separate foundation or the PIOB which would distribute the funds)?

We are concerned that the current funding arrangement, whereby IFAC and its members meet the costs of the boards and staff who support them, introduces a risk of excessive influence on the standard-setting process by the audit profession. A clear separation is necessary between the audit profession and the standard-setting process, and to support this the board and PIOB should become less reliant on the profession for funding. Contributions from Monitoring Group organisations and bodies representing the beneficiaries of standards, such as stock exchanges, are options could be explored.

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

Acknowledging the potential challenges to developing this on a sustainable basis, at the very least there should be a transparent, contractual arrangement which removes any discretionary element to the funding provided by the profession, which could give rise to undue influence. Similarly, administration of funding by the PIOB would provide an additional buffer to safeguard the integrity of the standard-setting process.

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

Please see our response to question 27, below.

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

Alongside concerns over audit standards, we have long felt that International Financial Reporting Standards are flawed. Their unclear over-riding purpose to provide information that is “useful for users” (as set out in the Conceptual Framework) and lack of any link to the goal of capital protection has resulted in seriously weakened accountability of executives to shareholders and, above all, resulted in a lack of visibility over companies loss-absorbing capital. This in turn has harmed the public interest as it has weakened trust in accounts.

In the case of banks, it has permitted unacceptable risks to be taken with shareholder capital and put entire economies at risk. But the problem of imprudent accounting affects all sectors, not just banks. Whether we are looking at pension liabilities, revenue recognition on long-term contracts, tax liabilities or foreseeable losses from climate-regulation, it is vital that companies apply a prudent mind-set in drawing up their accounts.

At the heart of our concerns regarding accounting standards is the fact that, for investors to be confident that they are not putting good money after bad, they need to know what portion of a company’s profit has been realised, and what portion has not. Understanding the level of realised profit is important to judging the reliability of a business’s income stream. It is also a key ingredient in determining a company’s true capital strength and ability to pay dividends.

The damaging role played by accounts was highlighted by the G20, the Financial Stability Board, the Bank of England, European Central Bank, a number of respected academics and thought-leaders amongst others. Although some changes have been made to IFRS, a decade after the financial crisis the accounting standards that contributed to the problems in the banks have not been properly addressed. We are now also seeing problems coming out in other sectors, e.g. construction and outsourcing, due to a lack of prudence embedded in accounting standards.

At the same time, reviews of governance at the IASB have drawn attention to weaknesses that require urgent attention. We would draw attention for instance to the European Parliament’s Directorate General for Internal Policies, Paper 7: IASB, published in 2015. We also highlight the own initiative report by the Economic and Monetary Affairs Committee (ECON) on “IAS evaluation and the activities of the IFRS Foundation, the EFRAG and the IOB, published on 3rd May 2016.

The Monitoring Group should therefore extend the scope of its enquiry into strengthening the public interest by examining the standard-setting process for accounting standards and their governance.