

Gerben Everts  
Chair  
The Monitoring Group

**By email**

9 February 2018

Dear Gerben,

**STRENGTHENING THE GOVERNANCE AND OVERSIGHT OF INTERNATIONAL AUDIT-RELATED STANDARD SETTING IN THE PUBLIC INTEREST**

The Financial Reporting Council (FRC) welcomes the opportunity to respond to the Monitoring Group's consultation on proposals to strengthen the governance and oversight of audit-related standard setting in the public interest. The FRC is the UK's Competent Authority for Audit, and regulates in the public interest. We are responsible for setting auditing and ethical standards in the UK, undertaking audit oversight and monitoring, and taking enforcement action where necessary. Through our work, we seek to underpin public confidence in the value of audit in the UK, and to support the delivery of high quality audit.

The FRC is strongly supportive of the objectives that the Monitoring Group sets out for the consultation and indeed, as an IFIAR<sup>1</sup> Board member, has provided resource to the Monitoring Group working group which our Chief Executive latterly chaired. The consultation paper builds upon a number of the issues raised in the Public Interest Oversight Board's 2017-2019 Strategy Consultation, on which the FRC commented publicly<sup>2</sup>. In our response we encouraged the PIOB to: strive further to set out a clear vision for the public interest; take steps to ensure that standard setting responds appropriately to that articulation of the public interest; ensure that standard setting is viewed by stakeholders as independent of the profession better to support public confidence; and take steps to ensure that the process of standard setting is timely and responsive to the developing needs of the market. The FRC acts with a view to "future-proofing" standard setting to meet evolving public expectations; not least that standards should be independently set.

Against this background, the Monitoring Group has necessarily developed an ambitious agenda in the consultation paper. We consider that it is important that the Monitoring Group now uses the momentum that it has generated, through the development of the consultation paper and the holding of the global round table meetings, to proceed with the reforms proposed and to finalise their scope and nature through the issuance of a prompt feedback statement and detailed final reform proposals. Further lengthy consultation on structure and strategy would, in our view, be contrary to the expressions of support for reform which is seen as serving the public interest.

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<sup>1</sup> International Forum of Independent Audit Regulators

<sup>2</sup> <https://www.frc.org.uk/getattachment/21432be5-8686-4da5-870f-0a74cc82553a/FRC-response-to-PIOB-strategy-consultation-Nov-2016.pdf>

However, there are areas where the Monitoring Group can build the public interest ambition further:

- Reform to standard setting needs to include a clear set of proposals for necessary and complementary reforms to both the PIOB and the Monitoring Group itself. The FRC, is strongly supportive of the actions proposed to strengthen the public interest. We believe that the public interest is likely to be better served through complete and coherent, rather than piecemeal reform. In developing its final proposals, the Monitoring Group should set out what it believes the main principles, objectives, roles and functions of each of those bodies should be. For instance, we agree with the Monitoring Group that there are clear benefits in a future standard setting board or boards operating more strategically – if that happens, an oversight mechanism that focuses on due process rather than high level principles and outcomes may not be fit for purpose, as it may not be able to focus resources on those areas where threats to the public interest are greatest.
- The Monitoring Group needs more boldly to articulate the need for, and take steps to implement, the multi-stakeholder funding model; as demonstration that audit is a public interest activity accordingly supported by public stakeholders. This requires acknowledgement on the part of the regulatory community represented on the Monitoring Group that they and their member organisations (and others) should make an ongoing and significant financial contribution sufficient to end the reliance of standard setting on funding provided by the profession. This will address the perceptions that: (i) standard setting is a form of self-regulation; and (ii) there is a correlation between the ability to pay and representation in, and ability to exert influence over, the standard setting process.
- Clear expectations and committed resources need to be brought to bear to implement the reforms safely, yet swiftly. Establishing a well-led board with a forward-looking and diverse supporting executive will be key to the new board setting an ambitious and responsive strategy in step with developments in public expectation and technology. We would like there to be a clear and ambitious implementation plan setting a timeframe for delivery of the new board's strategy.

We respond to the specific consultation questions below.

### **Responses to specific questions and requests for comment**

*Q1: 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?*

The FRC agrees with the key areas of concern that have been identified in the consultation paper. However, we encourage the Monitoring Group to ensure that the relevance and timeliness of standard setting is not viewed as a lesser order issue. As the Monitoring Group recognises, audit is dynamic and is changing quickly. Ensuring that high-quality standards are developed in time to support the needs of the market, and in a way that reflects the ever greater use of technology to deliver audit, is something that the future model must deliver. It is important that this is not overlooked. We consider that the existing standard setting process has delivered high-quality international standards and we think that the Monitoring Group should also publicly state that one of the objectives of any reform process is to continue to develop high quality standards, which support the delivery of high quality audit in the public interest.

*Q2: Do you agree with the overarching and supporting principles as articulated? Are there additional principles which the Monitoring Group should consider and why?*

The FRC agrees with the overarching and supporting principles as articulated in the consultation paper. If the final reforms proposed by the Monitoring Group adhere to these principles, this should help in further expanding the global adoption of international standards and will better underpin stakeholder confidence. Given the fundamental importance of standards in driving high quality audit, and ethical behaviour on the part of those who deliver it, the Monitoring Group might also consider setting a further principle that standards should be set in a way that drives high quality work. This would then offer a basis for assessing the effectiveness of standards in any post implementation review, to determine whether they had been instrumental in improving audit quality.

The supporting principles set out in the consultation paper highlight the importance of any reforms strengthening public accountability on the part of the standard setting board or boards, the PIOB and the Monitoring Group. We believe that reforms to the PIOB and Monitoring Group need to be aligned with reforms to the standard setting boards, rather than taking place on a piecemeal basis over the medium term.

*Q3: 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 FRC is supportive of the framework that the Monitoring Group has set out on pages 4 and 5 of the consultation paper – the public interest is fundamental to standard setting, and we strongly agree that the public interest as articulated should be used throughout the standard setting process to assess how effectively standard setting serves the public interest. We believe that the framework offers a good basis for evaluating whether a standard appropriately represents the public interest, but would caution the Monitoring Group against seeking to over-complicate what the framework might cover.

We strongly believe that any such framework should be high level and principles based. The public interest is best served by a framework supported by robust due process that encourages those who set standards to think critically about any standard they set, and how they ensure that it properly reflects the needs of users of financial statements. The public interest is best served by standards which drive auditors to respond appropriately to those areas in a set of financial statements which pose the greatest risk.

*Q4: 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.*

The FRC supports the establishment of a single board to develop auditing and assurance and ethical standards for auditors. A single board will help to ensure that there is an appropriate focus on audit as a public interest activity.

Appropriate oversight and co-ordination should be put in place to ensure that ethical standards for auditors are developed in accordance with a common set of agreed fundamental principles and objectives, shared with those developed globally for professional accountants in business.

This approach works well in the UK context where the FRC sets both ethical standards for auditors, and auditing standards, and professional bodies set the ethical codes used by professional accountants in business. We find that this allows for more effective co-ordination of both types of standards, and our experience has been that linking the development of

auditing and ethical standards supports a better and more challenging discussion by our Board (which is the standard setting body for the UK) and our Advisory Council which allows a more timely response to issues of public interest. Under the current international standard setting model, developments, even on coordinated projects, happen in one type of standard, and then there is a period of alignment as others are updated to reflect whatever changes have been made.

*Q5: Do you agree that responsibility for the development and adoption of educational standards and the IFAC compliance program should remain a responsibility of IFAC? If not why not?*

We agree that the development and adoption of educational standards should remain a responsibility of IFAC – our experience is that the profession is best placed to deal with the professional development requirement of members. Moreover, the profession and IFAC in particular should continue to have an important role in setting aspirations for audit in the future, encouraging innovation, and promoting the impact of the profession in serving the public interest.

*Q6: Should IFAC retain responsibility for the development and adoption of ethical standards for professional accountants in business? Please explain your reasoning.*

The FRC can see why the development and adoption of ethical standards for professional accountants in business might remain with IFAC, rather than moving to the proposed new independent board, although this does not sit well with the principle that standards should be independently set which is central to this consultation. Nevertheless, if IFAC continued to develop ethical standards for professional accountants in business, this would continue to ensure global convergence. Whilst there are differing requirements for auditors and professional accountants in business, we are clear that both serve the public interest. The standards set and the oversight they are subject to, need to reflect this. We also note in our response to question 4 that there needs to be appropriate co-ordination and agreement on a common set of shared fundamental principles which are used to develop both ethical standards for auditors and those for professional accountants in business at a global level.

We acknowledge that some stakeholders may be concerned at the separation of the development of ethical standards between two boards. However, we feel that the differing ethical needs for auditors and professional accountants in business (where, for instance, independence requirements are not as significant) can be better served by two boards. The FRC has previously raised concerns with IESBA that the Code of Ethics with its focus on ethical requirements for all types of accountant leads to requirements that reflect a lower common denominator approach, rather than one which reflects the public interest nature of audit and the needs of users of audited financial statements.

*Q7: 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.*

The FRC does not propose that the Monitoring Group consider further options for the organisation of standard setting boards. As noted earlier in this letter, we think it important for the Monitoring Group to articulate the future role, remit and purpose of the PIOB and the Monitoring Group itself, to provide stakeholders with a clear vision as to what a reformed model will look like and how it will work. It is also important that a swift and focussed implementation plan is developed and executed, resulting in a strategy for the reformed structure (see response to question 8).

*Q8: 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?*

The FRC agrees that the focus of a reformed board should be more strategic in nature. The board should focus on strategy and outcomes, and should be accountable for ensuring that those outcomes are delivered through standard setting activity. A reformed board should not focus on detailed technical drafting and amending drafts on a word-by-word basis, but should collectively have the technical strength to oversee the work of the technical staff and debate, challenge and approve standards. To be able to act strategically, the board will need to oversee an experienced and diverse executive.

The FRC also supported the proposal in the consultation paper that the members of a reformed board should be remunerated. This is an important step as board members will no longer be reliant on the financial support of a sponsoring organisation, and their independence will be enhanced as a result.

*Q9: Do you agree that the board should adopt standards on the basis of a majority?*

The FRC agrees that there are benefits in allowing standards to be adopted on the basis of a majority vote. However, this issue is more a reflection of the way in which the existing boards work, rather than having to follow terms of reference which set onerous requirements for the approval of a standard. The existing boards allow for the adoption of a standard by a two-thirds majority of members. In practice, standards are almost always adopted on the basis of a unanimous vote.

Holding out for a unanimous vote runs the risk that the adoption of a standard can be delayed by individual board members which may not be in the public interest. Seeking to persuade an individual to support a unanimous vote may also mean that an individual may be able to exert disproportionate influence over the development and approval of a final standard, which again, may not be in the public interest. However, gaining widespread board support from all represented stakeholder groups helps to provide a standard with credibility that it has been developed having taken account of the views of all stakeholder groups, this in turn should support its global adoption.

On balance, therefore, the FRC does not support setting a low hurdle (simple majority) for the adoption of a standard which might never be used. It is important that international standards have credibility among stakeholders, and the FRC is minded that it should be part of the accountability process for the Board Chair to ensure that the approval of a standard is broadly supported by board members, but in the event that approval is delayed by an individual or individuals who are asking for amendments that the Chair considers unreasonable, then they should move to a majority vote as the basis for approval. Our preference would be for a high majority (two-thirds or three-quarters) to approve a standard, with the reasons for dissenting views being placed on the public record.

*Q10: 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 FRC endorses a single board model (question 4). We believe that the membership of that board should be designed to ensure that it has appropriate representative diversity among its

members to command the support of stakeholders. We believe a larger board of 15 would better achieve this, and also avoid a deadlock in decision making with an odd rather than even number of members (albeit that we favour a consensus approach). When considering whether the board is appropriately diverse, the standard setting process as a whole will need to be considered – the board should be considered along with the Monitoring Group and PIOB to ensure that there is appropriate stakeholder representation.

Our preference is for the majority of members to be part time – the main reason for this is to make the work of the board more attractive to non-practitioner candidates who may apply for membership. We have heard repeatedly from investor and audit committee stakeholders that there is little appetite to join a standard setting board that requires a full time role. However, we do recognise that the Chairmanship of the Board needs to be a (near) full time role, reflecting the need to provide leadership to the board and also engage with stakeholders. The Chair should be supported by two (near) full time deputies who could either be accountable for elements of the board's work (e.g. auditing standards and ethical standards respectively) and/or could provide more resource to support the outreach work that the board and executive will need to undertake.

The FRC agrees that members should be drawn from different stakeholder groups as set out in the consultation paper. Given the current purpose and scope of audit, we suggest that, rather than having three distinct stakeholder groups from which members are drawn, there should be an obligation on the board to ensure that it contains adequate investor representation. As we have already commented, when considering the make-up of the board, this should not be done in isolation and should take account of stakeholder and geographic representation at other levels of the standard setting process. This should be kept under review as the scope and nature of audit evolves.

*Q11: What skills or attributes should the Monitoring Group require of board members?*

Most importantly, the FRC believes that members of a reformed board should have a clear focus on, and be responsive to, the public interest. This should drive their work on the board and how they respond to challenges or questions that the board has to deal with. Board members should also be independent, have skills that are relevant to the board's work at a level that makes them credible participants, fully aware of the issues that are of relevance to stakeholders and will support the global adoption of the standards developed. Board members must also be able to work collaboratively with stakeholders and with the other parts of the standard setting process. The PIOB, as the proposed Nominating Committee of the board in the medium term, should be accountable for ensuring that collectively the Board has the right mix of skills and attributes effectively to deliver its work.

*Q12: 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 FRC is supportive of the CAG as a mechanism to gather stakeholder input into the board's work, although this is not and should not be the only means of doing so. We would encourage the Monitoring Group to consider again the membership of the CAG with a view to ensuring better representation of investor views and those charged with governance. We also suggest that the terms of reference be amended to specifically require CAG members to represent and act in accordance with the public interest in their engagement with the standard setting board.

*Q13: Do you agree that task forces used to undertake detailed development work should adhere to the public interest framework?*

Yes, the FRC agrees that any task forces should be required to adhere to the public interest framework.

*Q14: Do you agree with the changes proposed to the nomination process?*

Yes, the FRC agrees that the PIOB should become the Nominating Committee for the reformed board. This will further assist in developing strong and clear lines of accountability.

*Q15: 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 FRC welcomes the Monitoring Group's proposals to expand the role and remit of the PIOB. The FRC would like to see a more explicit statement of the Monitoring Group's expectations for the PIOB which take account of the comments we have already made in respect of the public interest framework (question 3).

In addition to the functions set out in the consultation paper, and the question we raise in our response to question 16 below, the PIOB's remit should acknowledge that:

- If a reformed board is more independent than its predecessors, a different type of oversight is needed, which reflects the risk that a standard or standards poses to the public interest, rather than focusing purely on due process oversight;
- The PIOB should engage collaboratively with the board to ensure that standards that are developed will best represent and support the public interest; and
- The PIOB will ensure public accountability for the delivery of the board's strategy and report on this to stakeholders.

The FRC does not support the idea of the PIOB having an ability to veto the approval of a standard – the standard setting board should be recognised as the technical authority with the power to approve a standard. If the PIOB has concerns that a standard has not been developed in the public interest, then it should set out the actions necessary to address this before a standard is finalised.

The FRC is fully supportive of the PIOB's role developing so that it is more akin to the IFRS Trustees, particularly in respect of being responsible for the collection of funds to support the board's work, and approving the board's budget. We recognise that this will require additional resources to support this expanded mandate. We also again emphasise the need for clear and robust lines of accountability between the board, the PIOB and the Monitoring Group to ensure that different levels of the standard setting process cannot be 'played off' against one another. To that end we welcome the Monitoring Group's commitment to setting out a clear statement of the respective roles and responsibilities of the PIOB and the Monitoring Group. Currently, we have concerns about the PIOB being referred to as 'the executive arm of the Monitoring Group' which implies that it exists to carry out work that the Monitoring Group is unable to do itself. We believe instead that roles and responsibilities should be clearly defined, and should not be arrived at by default.

*Q16: Do you agree with the option to remove IFAC representation from the PIOB?*

Yes, the FRC agrees that IFAC should not be represented on the PIOB. The FRC suggests that the Monitoring Group set out clearly how its expectation that *'the PIOB as a whole has an*

*appropriate technical understanding of audit matters by taking the advice of auditing experts within the Monitoring Group such as IFIAR' will work.*

*Q17: 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 overriding skill will be the need for members of the PIOB to understand the public interest, and to consider issues that it needs to discuss from that perspective. We also believe that the skills and attributes set out in our response to question 11 should also apply to PIOB members, although in the case of the PIOB there will be no requirement for any members to have detailed technical knowledge of auditing or ethics (from an audit-related perspective). We also believe that the PIOB membership collectively should meet the same appropriate representative diversity requirements to command the support of stakeholders as has been set out for the standard setting board (see response to question 18).

*Q18: 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 organisations, or do you have other suggestions regarding the nomination/appointment process?*

The FRC believes that members of the PIOB should be identified through a nominations process which starts with an open call for nominations, and ends with an appointment approved by the Monitoring Group acting as the PIOB Nominating Committee. The FRC does not support appointments to the PIOB made on the basis of a single candidate proposed by a Monitoring Group member.

As for the reformed board, nominations to the PIOB should be open and transparent, and should set out clear lines of accountability between the PIOB and Monitoring Group. The PIOB should also be required to achieve the same representative diversity as that proposed for the standard setting board. The Monitoring Group should give serious consideration to adopting the same multi-stakeholder approach as proposed for the standard setting board, although in order to avoid undermining stakeholder confidence, current practitioners should play no role in oversight. Drawing on the FRC's experience on our own board, we suggest that a cooling off period of five years should apply before a (former) practitioner is eligible to join the PIOB.

*Q19: 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?*

PIOB oversight should be undertaken for all standards that are set in the public interest, and not just those that are set by the board or boards for setting auditing and assurance standards and ethical standards for auditors. However, we believe that any oversight activity should be determined by the risk posed to the public interest by a standard or standards. For standards that are determined to be of a low risk to the public interest (e.g. International Education Standards) it may be that the scope of oversight activity is confined to a review of strategy and planning documents, and ensuring that appropriate public consultation and accountability mechanisms are in place.

*Q20: 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?*

The FRC supports retaining the three tier model for standard setting, and believes that the Monitoring Group is an important way of discharging public accountability. However, we believe that there is merit in the Monitoring Group seeking to align better and co-ordinate its work with the IASB's Monitoring Board which serves a similar function in accounting standard setting, and operates at a more senior level. The Monitoring Board was established with the aim of "providing a formal link between the Trustees and public authorities" in order to enhance the public accountability. The FRC encourages the Monitoring Group to look to develop its own role in a similar way, in particular seeking better to formalise the way in which it works, and operating with greater transparency to support public accountability.

*Q21: 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 FRC strongly supports the work of the standard setting board being supported by an enlarged technical staff, allowing technical drafting to be carried out by the board's staff for the board's approval. It will be important for the expanded staff to have skills appropriate to support the development of both ethical and auditing standards, and to also have strong project management and stakeholder engagement capabilities to support the work programme of the board as a whole. A larger staffing complement will also require an enhanced management capacity to provide oversight, coaching and development and technical review as necessary.

*Q22: Do you agree that permanent staff should be directly employed by the board?*

Yes – the FRC agrees that permanent staff should be directly employed by the board.

*Q23: Are there other areas in which the board could make process improvements – if so what are they?*

The board should adopt a process for dealing with minor issues or urgent issues requiring an immediate response through an annual update process, like the IASB. In developing its processes, the board should keep in mind the principles of better regulation.

*Q24: 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)?*

Yes, we believe that it is possible to put in place appropriate checks and balances to mitigate risks to independence; however, these will not fully address concerns expressed by stakeholders over the perception that standard setting is not independent or carried out in the public interest because it relies on the profession to meet its costs. Measures might include using the PIOB to collect and approve funding for the standard setting board in the same way that the IFRS Trustees do for the IASB.

However, these checks and balances should not be used as an excuse not to address in the short to near term the need to establish a sustainable long term funding model for audit-related standard setting that significantly reduces the dependence that the current model has on

funding provided by the profession (although as the major user and beneficiary of high quality standards, it is right that the profession should be required to make a significant payment towards the cost of this). We have set out earlier in this letter our belief that there should be a significant funding commitment on the part of the regulatory community, which would reflect: (a) the collaboration of independent regulatory authorities in the standard setting process; and (b) a continued legitimacy for oversight of audit-related standard setting by the Monitoring Group. Without funding from this stakeholder group, we do not see how the current funding base can be diversified.

Although these proposals may be seen as radical, it is worth remembering that since its inception, the PIOB has been unable to secure a diversified finance base and continues to rely on IFAC for the majority of its budget. Only a fundamental change to the status quo will achieve the level of change required to support standard setting in the public interest.

*Q25: 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?*

We believe that this is not an optimal solution to the issue to be addressed, other than to cover a transitional period in which a new funding model is being established. However, we do agree that, where the profession makes payments towards the costs of standard setting, this should not be on a discretionary basis (e.g. as the Monitoring Group has no statutory power to raise levies, funding would need to be underpinned by a contractual mechanism). See our comments at the start of this letter and in response to question 24.

*Q26: In your view, are there any matters that the Monitoring Group should consider in implementation of the reforms? Please describe.*

If the Monitoring Group's reforms require the establishment of a new entity to take forward standard setting, this should be supported by a detailed transition plan, and the necessary resources to allow that work to be undertaken in a way that will minimise disruption to the standard setting process. It will also be important that reforms do not delay any of the current major projects currently being carried out by the existing standard setting boards. As set out earlier in this response, we strongly believe in the need for clarity over reforms to the PIOB and Monitoring Group and for these to be clearly set out as part of the reform plan.

*Q27: Do you have any further comments or suggestions to make that the Monitoring Group should consider?*

We have no further comments to make, other than to place on record the need for the Monitoring Group to articulate a single, complete and comprehensive series of reform proposals, along with an ambitiously realistic transition timetable and plan, once it has had the opportunity to consider all stakeholder responses.

Please do not hesitate to contact me should you wish to discuss any issues raised in this letter.

Yours sincerely

A handwritten signature in black ink that reads "Melanie". The letters are cursive and fluid.

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