

Submitted by e-mail to:
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Ref: Monitoring Group Consultation: Strengthening the Governance and Oversight of the International Audit-related Standard-setting Boards in the Public Interest

Dear Mr Everts,

DEAR GERBEN,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the Monitoring Group's Consultation on *Strengthening the Governance and Oversight of the International Audit-related Standard-setting Boards in the Public Interest* (hereafter "*the Consultation*"). We are pleased to provide you with the following comments, from a securities regulator perspective, with the aim of improving the public accountability and effectiveness of the international audit-related standard-setting bodies.

Building on the views on governance of these bodies already expressed in response to the 2012 Public Consultation¹, ESMA strongly welcomes *the Consultation* and its focus on the public interest. ESMA believes that the proposed changes are a necessary step in the right direction to increase the independence, public accountability, quality and effectiveness of the international audit-related standard-setting process.

ESMA has consistently argued that audit-related standard-setting activities should be carried out by a dedicated independent organisation subject to public oversight, safeguarding the public interest. Consequently, ESMA considers that *the Consultation* has appropriately identified and articulated the key areas of concern with the current standard-setting model in the audit area. While ESMA believes that *the Consultation* appropriately articulates the main public interest principles, we are of the view that the proposed governance should reinforce, on a timely basis, the safeguards related to the independence and integrity of the standard-setting process.

¹ Letter: ESMA response to the Public Consultation on the governance of the Monitoring Group, the PIOB and the standard-setting boards and Compliance Advisory Panel operating under the auspices of IFAC, ESMA, Paris, 9 August 2012

The Board and its remit (Q4 - Q7 of the Consultation)

ESMA supports establishing a single independent Board composed of a qualified majority of full-time members to develop and adopt auditing and assurance standards as well as ethical standards for auditors. ESMA is of the view that, due to the inherent interdependence of auditing and assurance standards with ethical standards for auditors, retaining separate boards is not justified, neither from effectiveness nor from cost-benefit perspectives. ESMA also accepts that the scope of the new Board shall not immediately include the development and adoption of ethical standards for professional accountants in business. In ESMA's view, as the profession of the auditor operates in a different regulatory framework requiring a different level of independence, synergies between the development of ethical standards for auditors and professional accountants in business should not be overstated. However, enlarging the scope of the Board's activities to this domain in the future could be further investigated.

While ESMA is of the view that the main responsibility for development of educational standards and compliance should remain with IFAC, similarly to the model adopted by the IFRS Foundation, the professional staff supporting the new Board should engage in educational activities that would facilitate the understanding and adoption of the International Standards of Auditing (ISAs) around the world. Similarly, sufficient attention should be paid to research activities needed to enable the Board to base the standard-setting process on evidence.

Composition and governance of the Board (Q8 - Q14 of the Consultation)

ESMA agrees with the Monitoring Group that the focus of the Board should be more strategic in nature, although individual Board members should have the necessary technical competences and experience for giving direction to the highly qualified **independent** technical staff supporting the Board and discussing and challenging their drafting proposals. ESMA also agrees that in order to be able to attract the right expertise and ensure independence of the Board from the audit industry, the members of the Board should be remunerated at a level commensurate with their expertise and time commitment. While ESMA believes that a size of the Board between 12-14 members provides an appropriate balance between effectiveness and representativeness of the Board, we are of the view that the Monitoring Group should refine its proposals with regard to the composition of the Board in order to ensure independence and integrity of the standard-setting process. Consequently, ESMA emphasises that the Board should be composed of highly qualified professionals, who, whether working for the Board on a full-time or part time basis, should not be the representatives of the "nominating organisations" but should work independently in the public interest.

In particular, ESMA is of the view that the reform should ensure a sufficient number of full-time members of the Board. ESMA acknowledges that part-time positions have to be available for certain stakeholder groups because it is unlikely that investors and academics are willing to serve as a board member on a full-time basis. However, in our view, not more than 5 members should be appointed to serve on a part-time basis. While ESMA believes that *the Consultation* proposes a balanced representation of the various stakeholders groups, we propose that

members that had recently held active practitioner function should qualify only for the full time membership of the Board and be precluded henceforth to engage in active audit practice in order to avoid [the perception of] a conflict of interest. This would further strengthen the independence of the standard-setting process that is currently contested due to active practitioners serving as part-time members of the IAASB. For this purpose, a sufficiently long cooling off period should be defined, after expiry of which, members could qualify for part-time membership of the Board, if not planning to engage in active audit practice. However, ESMA could envisage that, in duly justified exceptional circumstances, the PIOB could appoint one part-time active practitioner to the Board, if it considers that it is necessary to provide current practical expertise on audit and ethics issues.

ESMA agrees that the Board should decide based on a majority. However, we are of the view that for adoption of a Standard a qualified majority of approximately 2/3 of Board members would be required in order to achieve a sufficient level of support. Nevertheless, the qualified majority requirement should not imply that members who are practitioners or who had recently a practitioner's function could exercise an effective veto over the Board's decisions.

ESMA agrees to retain the concept of a Consultative Advisory Group (CAG). However, ESMA considers that the membership of the CAG should be enlarged to enhance its representativeness, in terms of types of stakeholders and their geographical balance. Furthermore, the Board should use the CAG as a sounding board for strategic decisions, annual and multiannual work plan and major directional questions rather than discuss detailed issues (such as e.g. drafting of the decisions).

ESMA agrees to the proposed changes to the nomination process of the Board members. However, ESMA suggests that the Monitoring Group makes clear that the Board members should be selected based on an open public call for nominations in a transparent appointment process. Finally, we strongly believe that all Board members should be appointed only for a defined maximum time period (e.g. term of up to 5 years with a possibility of a single re-appointment for a period of up to further 5 years).

Role of the PIOB (Q15 - Q19 of the Consultation)

While ESMA agrees with the proposed role of the PIOB, we believe further clarifications might need to be provided. ESMA considers that the role of the PIOB should be to ensure the adherence to the public interest framework and public accountability rather than be involved in detailed technical decisions. Consequently, ESMA is of the view that it should not be the role of the PIOB to challenge or veto technical decisions of the Board unless there is a concern that the public interest is not served. At the same time the PIOB should scrutinise the due process of adoption of the standards and be able to delay or oppose adoption of a standard if the due process that aims to respect the public interest was not adhered to or in case independence or integrity of the standard-setting process was breached. Consequently, the role of the PIOB should not be limited to mechanistic checking of due process, but to understand how the development of the new standard serves the public interest. This should



include the approval of the annual and multiannual work plan and prioritisation of the Board resources in order to enable timely finalisation of standards that are in the public interest.

ESMA supports the Monitoring Group's request to the PIOB to develop a framework that serves as a mechanism for assessing how the public interest is captured throughout the standard-setting process. ESMA suggests that such framework is opened for public consultation before finalisation. In ESMA's view, this would increase trust in the functioning of the PIOB as guardian of public interest.

ESMA suggests that the Monitoring Group clarifies the decision-making arrangements of the PIOB. In this context, ESMA believes that the PIOB should decide by a simple majority (for most decisions) or a qualified majority (e.g. in case it would like to delay or oppose a standard).

ESMA agrees that IFAC should not be a member of the PIOB. ESMA equally agrees that, members of the PIOB should be independent and should avoid any appearance of conflict of interest. In this respect, ESMA considers that the PIOB members should be identified through an open call for nominations from both within the Monitoring Group member organisations as well as other representatives of the civil society in order to be representative of the public interest.

ESMA considers that the PIOB should primarily focus on oversight of the Board, rather than on oversight of different activities that would remain under the auspices of IFAC, given the different governance and oversight processes. On the other hand, such focus should not prevent individual members of the PIOB to be able to serve on a different body supervising the activities that remain under IFAC.

Role of the Monitoring Group (Q20 of the Consultation)

ESMA agrees that the role of the Monitoring Group is likely to evolve following the reforms set out in the Consultation. Consequently, after the current package of the governance reforms is put into practice, the Monitoring Group might need to reconsider its role in the oversight process.

Professional staff (Q21-Q22 of the Consultation)

ESMA highlights the importance of supporting the work of the Board with professional and independent highly-qualified technical staff that is directly employed by the Board on a full-time basis (rather than the current model that relies on "technical advisors"). In our view, this is an essential pre-requisite for the Board to conduct high-quality standard-setting activity. In ESMA's view, the Chair of the Board should ultimately be responsible for all staff appointments and not only senior staff as proposed in section 6 of *the Consultation*.

Funding (Q24 - Q25 of the Consultation)

ESMA welcomes the Monitoring Group's objective of creating a funding model designed to enhance independence of the standard-setting process. ESMA considers that in the long-term the standard-setting process should be financed through an independent funding mechanism

based on entities benefiting from the standards (e.g. a form of a contractual levy could be further explored) in jurisdictions benefiting from the standard-setting process (either directly using the ISAs in practice or indirectly by developing local auditing standards based on them). In our view, such mechanism should be designed to ensure that all relevant entities benefiting from the standards contribute to the financing of the standard-setting process (i.e. entities audited, their auditors, investors as well as the supervisory community/public sector).

ESMA sees great importance in the funding model for the overall success of the reform of the audit-related standard-setting process. Therefore, ESMA is of the opinion that the Monitoring Group should formulate a more detailed funding proposal after sufficient but timely deliberation. ESMA is of the view, that as an interim step the Monitoring Group should develop a roadmap including a comprehensive perspective of what additional measures will be undertaken to set up an independent stable funding mechanism.

While the funding mix would continue to rely, in the foreseeable future, on the contributions from audit firms, ESMA considers that the Monitoring Group should engage with jurisdictions using the ISAs to set up an independent, stable and sufficient long-term funding mechanism financing the standard-setting process.

However, in the short term, ESMA considers that the proposed checks and balances might be appropriate to mitigate the threats to independence and integrity of the standard setting process due to continuing reliance on the financing through the direct contribution of the audit firms and the accountancy profession.

Other considerations

ESMA considers that, as part of the standard-setting, specific attention should be paid to sustainability and impact of sustainable finance on the audit process. This might necessitate, over time, development of specific audit standard(s) for assurance services on non-financial statements.

At the same time, ESMA considers that the reference to technology should be further developed concerning digital reporting, as technology significantly impacts and is expected to continue to impact all financial areas.

Please do not hesitate to contact me, or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu) should you wish to discuss any of the issues raised in this letter.

Yours sincerely,



Steven Maijoor