

Response of Susan Koski-Grafer

To Monitoring Group Consultation Paper "*Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Boards in the Public Interest*"

February 8, 2018

Dear Ladies and Gentlemen of the Monitoring Group, IFAC, and Other Stakeholders:

My comments in this response reflect my observations and experiences in the following roles and fields over a period of more than fifty years:

- as a preparer and user of financial statements in a listed public company,
- as a participant and supervisor of technical and professional development work in an association of senior financial executives,
- as a member of the staff of the U.S. securities regulator interacting with securities regulators and other regulators and oversight organizations in other countries on matters relating to accounting, auditing, internal controls, standard setting and corporate governance,
- as an independent consultant providing research and analysis services in a litigation support, corporate governance and business consulting firm,
- and, finally, as a private investor.

I have never worked as an auditor but have interacted extensively with auditors as a member of the financial reporting organization in an audited public company, and also as a regulatory representative observing audit standard setting activities.

I provide this description of my background only to establish my frame of reference in responding to this Consultation paper, and not in any way to purport to represent present or past positions of any of the organizations for which I have worked.

Over the years, it has been my privilege to work with - and learn from - many different types of individuals and organizations, and my views have evolved accordingly. Any views I now express in this letter are solely my personal opinions and observations from the totality of these experiences. With this said, the following are my responses to the questions and issues raised in the Consultation Paper.

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?

The three key areas of concern listed are appropriate; however, an additional key issue and area of concern should be to study the impact on audit quality, auditor behavior, and auditor performance arising from the current standards processes, the outputs produced, and how the standards are used in practice. Without prejudging the outcome of such an examination, it would seem highly relevant to examine how the existing standards are actually interpreted and used in audit firms and applied by audit personnel at all levels. This would include looking at how the standards affect and are affected by the policies and internal instructions that audit firms give to their staff, and at whether and how the application of the existing body of standards has contributed to successful audits or audit failures.

Public confidence in financial statements and in the auditing of those statements is influenced most significantly by what happens in audits out in the marketplace. Occasional highly-publicized failures in reporting and auditing, and scandals that involve auditors and audit firms, will undermine public confidence no matter what enhancements are made to standard setting processes.. While standards can never guarantee that no mishaps will occur, high quality standards set in the public interest can reduce the risk of problems and failures, both in audited entities and within organizations doing the auditing.

Without fully addressing the larger issue of impact on audit quality and risk of failures, anything added to or subtracted from the current structures and processes of audit standard setting is not likely to significantly strengthen public confidence in either the processes or the outputs.

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

I agree with the overarching and supporting principles listed but would suggest that “Efficient” and “Productive” be considered as sixth and seventh principles or criteria that describe a standards setting process that is in the public interest. Alternatively, one or both of these considerations might be captured in the principle “Cost effective” if it were broadened to focus on costs and benefits within the process producing the outputs as well as the cost/benefits of the outputs (standards) themselves. The reason for this comment is that it may be possible to achieve greater benefits from standards set in the public interest with simpler processes and documentation and streamlined efforts that would enable standard setting work to be accomplished more swiftly and effectively.

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 term “due process” is cited frequently in discussions of standard setting as essential to ensure that standards are developed in the public interest. The numerous steps and requirements in the current due process arrangements appear to have been instituted both to ensure and to demonstrate that stakeholder issues have been fully considered and that no stakeholder group can exercise undue influence in the content of standards. This due process is important; however, it may also be useful to examine the idea of “process” more comprehensively, to look at the “process overall” or “total process”.

In efforts to demonstrate that standard setting is taking place in the public interest, a risk exists that the use and application of due process and the steps and outputs involved (e.g., project steps, meeting agendas, feedback statements, etc.) can become overly mechanistic, elaborate and detailed without necessarily achieving real communication and understanding. The procedural steps involved can unintentionally result in a lot of efforts that are carried out by capable and dedicated people, yet do not always produce the desired results.

In examining and seeking to strengthen the standard setting process and its results, additional insight might be obtained by doing a task analysis of the total end-to-end activity involved in creating a standard. Including how the idea for a project arises and how the project is shaped, how the communications and work in task forces is carried out, and how issues are articulated and examined during the standard development process and how many other large and small components of the process affect quality and progress. In addition, the concept of “process” should be enhanced to take into account human performance considerations and human behavior dynamics, e.g., how groups work together and how much information can be reasonably be comprehended and absorbed and reacted to at any point, and other human factors.

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.

I strongly support establishing a single board. The existence of two boards inevitably creates a constant need for formal interfaces and communications, thereby adding to the necessary steps, stops and starts in the process of developing a standard. Having two separate boards also adds to infrastructure and overhead costs and can lead to over-compartmentalization, delaying progress in standards projects and adding to complexity in standards.

It would seem ideal that ethics issues could be considered with other standards issues in a more integrated manner - whether a given standard is for auditing or for other forms of assurance or for other services provided by professional

accountants, it should contain coverage of relevant ethics issues directly or by reference to appropriate ethics content. Having a comprehensive single set of standards could help reduce the occurrence of gaps and conflicts and uncovered subjects in the standards. Even if a completely separate set of ethics standards is retained in the present form, having one board address auditing, assurance and ethics standards could aid in moving thought processes and board and staff project work to a more cohesive approach. Please see also the response to question 6 for additional comment relevant to this subject.

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. IFAC and partners and sponsoring organizations have long led the development of the global accounting profession through education efforts, educational standards, and compliance programs carried on throughout the world. It would seem highly desirable for this work to continue, as it contributes to improving financial management, accountability and stability in the world markets and it is IFAC who has the structures and processes in place to do this work and make modifications as may be needed over time.

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

Probably not. It seems desirable to include all ethical standards in the standards work of a single independent board addressing auditing and assurance and ethics and independence standards. Having a separate body of standards for professional accountants in business developed by IFAC could add to complexity, interface issues, and unnecessary distinctions. It could be difficult for IFAC to adequately monitor and enforce the application of such standards as a separate body of requirements.

My personal perception, standing back with a multi-stakeholder perspective, is that the vast body of work done by professional accountants can most logically and simply be divided into three broad categories: "auditing services", "other assurance services", and "accounting and business services". With the latter category "accounting and business services" encompassing a wide range of professional activities, including everything from preparing books and records... to tax services and other financial services... to all the business consulting, advising, problem solving and other services (e.g., executive search) that are today being provided by professional accountants and accounting firms to clients. This third category also seems to readily apply to the work of accountants who are employed as management and staff in business and other organizations.

In a framework such as this, some ethics requirements would apply across-the-board to all three categories, while others might apply only to audit work. Some requirements might be specific to certain types of engagements or in particular work circumstances.

I believe that a stronger set of standards for guiding and supporting ethics of accountants in business could be achieved by one independent board developing such standards as part of a cohesive whole described above.

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.

I believe that the Monitoring Group should consider whether and how such individuals as interns, secondments from stakeholder organizations, contractors, and other occasional or specialized participants can properly and effectively be used to advantage in standard setting and oversight activities, and how independence can be assured in any usage.

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?

It is not clear to me exactly what specific differences in actions would be involved in the board being "more strategic and less operational" so my answer here is tentative. I believe a standard setting board is most effective if it involves a mix of strategic and operational views and actions, I agree with all the responsibilities listed in the Consultation Paper, with a suggested modification in one of the paper's statements to read instead that the board "would not ordinarily draft text itself in board meetings". (Change underlined) The reason for this suggested modification is for both efficiency and effectiveness – for example, if the staff or a task force leader is presenting proposed language for a standard in a board meeting and in the board discussion that follows, a change or a better phrasing is identified and tentatively agreeable to all present, it seems most efficient and desirable to incorporate that enhancement then and there and move on. There should always be room for acting on synergy and inspiration in any group meeting,

In a second comment, the phrase "undertaking broad outreach" is something that it would be helpful to define more specifically as the planning process continues., Considering the differences in formal outreach activities, e.g., via publications and events, speeches and presentations as opposed to outreach via informal group and individual contacts, observing in meetings, or other activities, it would be helpful to clarify what is envisioned to be done and by whom. Outreach can

occur in a wide variety of forms and sometimes the forms that involve listening and observing more than talking can be extremely illuminating and valuable.

I agree that board members should be remunerated, and by the organization that is developing the standards.

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

Yes. I am not sure whether this should be a majority or a super-majority. Whichever is used, provision should be made to publish dissenting views in an appendix to a standard to provide the dissenter's stated rationale for same.

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?

Having both full-time and part-time members seems appropriate and reasonable if the distinction between full-time and part-time can be achieved by making adjustments in the amounts of time spent in activities other than full board meetings. I believe that all board members should attend all board meetings. Board members should also have some amounts of participation in the other types of board activities; however, the amounts of time spent by individual part-time members can reasonably vary with individuals and compensation amounts adjusted accordingly. Care should be taken not to create a "two-tier" effect in the information supplied to board members in preparation for main board meetings.

Stakeholder representation and other common diversity needs (e.g., geographic origin, gender, etc) should be presented as goals and guidelines in board composition, not as fixed quotas to be achieved. "Age diversity" should also be considered as a potential benefit in board work – this issue has become more recognized in the business environment in recent years. It is sometimes described as age or cohort diversity, mixing "millennials and perennials", or with other terminology. But whatever it is called, the concept involves drawing upon both the old and the young to bring different experiences, skills and knowledge to enhance the work of organizations.

When one thinks of the populations that actually are and will be using auditing and assurance and ethics standards in practice, and also reflects upon how much business and social change has occurred in recent years, innovation in communications, etc., these all suggest that perhaps additional benefits in understanding can be achieved if the creators of standards are representative of the full range of users of standards, at least in part.

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

Of course a range of solid technical knowledge and professional experiences is fundamental. However, of equal importance should be a number of “soft skills” - a person’s willingness to listen to others and seek to understand their experiences, issues and concerns; patience and respect for differences in opinion; an open mind; ability to communicate well and the tenacity to speak up. A board member should also have a willingness to consider new ideas that are presented, and to question assumptions, existing models and approaches when warranted.

Knowledge of the work of accountants and auditors – amounting to general knowledge for some, and detailed knowledge and practical experience for others, is required. An understanding of the role of financial reporting and auditing in the capital markets is important, as is some awareness of the roles and work of various stakeholder groups. It is also important to be aware of the challenges that professional accountants may face in providing services in developing countries, and differences in operating environments and practical needs in smaller business entities.

Insofar as a “skills matrix” is concerned, while this can be a useful tool in considering both individual attributes and overall board composition, care should be taken that the tool does not become “an end in itself”, i.e., that it is not overly detailed or used arbitrarily in a rigid, formulaic way without allowing for exceptions or judgment or tradeoffs. Any list or matrix used in the process should contain a mix of hard and soft skills and attributes.

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?

A consultative function that includes occasional face-to-face meetings is highly desirable, especially if the meetings are designed to allow adequate time for full and lively discussions on selected key matters, and if agendas and discussion papers are not so elaborate and overly detailed as to be overwhelming to professionals who are not employed as auditors. It is important to design the papers for ease of reading and to provide ample notice and preparation time for attendees. This is especially important in an international body where English is a second language for some participants.

It is also desirable to allow some time in each meeting for CAG members to raise unplanned issues and/or to share information of interest from the organizations they represent. The CAG membership currently indicated on the IFAC website seems reasonable.

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

I am not sure that I understand this question. If the board members and staff are all expected to act in the public interest and to affirm same, and they would be the persons comprising task forces, why would this issue arise? If the question is intended to refer to outside experts, speakers, or contractors that might at times participate in a task force's work, one would think a regard for the public interest would be expected for them as well and taken into account in extending any invitations. However, outside individuals should be free to express strong views that they advocate as well as provide requested information, and would not necessarily be signatories on any affirmation statement.

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

Yes

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?

Challenge yes, veto probably not. For a proposed standard to reach a point where the Board approves a standard but one or more PIOB members thinks it should be vetoed to me indicates a failure in the process of serious concern. And is a situation that therefore requires more action than a veto.

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

In my reading of this Consultation Paper I did not recognize a statement explicitly describing an option to remove IFAC from the PIOB. I did see discussion of changes in the nominating process for the standard setting boards whereby board member nominating functions would move from IFAC to the PIOB. I would support such changes in board nominations, with the observation that IFAC should still have some role in the process. IFAC has provided significant services and leadership in developing and supporting the global accounting profession. Its efforts have improved financial management and accountability around the world. It has developed a significant body of knowledge and experience in conducting standard setting work for many years.

While there needs to be more separation of IFAC from the PIOB, I believe the role and experience of IFAC justifies its ongoing inclusion as a major stakeholder and warrants giving IFAC a seat on the PIOB. This should be done even if major changes are made in the structure and process for audit and assurance and ethics standards setting, and even if the PIOB's oversight remit is changed to focus only on that standard setting and not to include IFAC activities related to education and compliance.

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?

My response here is largely the same as my response to Question 11 regarding personal attributes of board members, e.g. ,a mix of hard and soft skills and a mix of detailed and general professional knowledge and experience in stakeholder groups, etc. For the PIOB however, I would also recommend that members also have significant knowledge of corporate and other governance principles and responsibilities, along with experience in leadership roles in stakeholder organizations.

On an ongoing basis, it would be desirable for the PIOB to plan and carry out periodic self-assessments and discussions relating to how governance issues are being addressed, both within its own operations and in the processes it is overseeing, to identify opportunities for continuous enhancement.

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?

I believe that an open call process involving the Monitoring Group members, IFAC, other stakeholder groups, the existing PIOB members, and individual recommendations as well as self-nominations can provide the strongest pool of good candidates.

I believe that an optimum review and evaluation process, while necessarily conducted privately, should also involve oral consultations among leaders in the Monitoring Group, IFAC, and possibly certain other stakeholders, when a short list is developed.

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?

PIOB oversight should focus only on standard setting auditing and assurance standards and ethics and independence standards set by a single board. As discussed in my answer to Question 6, I think ideally the single board should also set ethical standards for professional accountants in business.

There is an inherent interaction and a degree of interdependence between auditors and professional accountants in business that argues for considering the population in total where ethics are concerned, even if additional requirements apply for auditors. In addition, I think that large numbers of dedicated professional accountants in business must operate with many challenges and pressures, and would benefit from the existence of a more visible and integrated body of understandable and high quality ethical standards to support their work.

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, although with the implementation of the reforms discussed in this Consultation Paper and perhaps others, I would think the PIOB's level of activity and time commitments directly observing and attending standard setting activities could likely become less extensive and less "hands on" over time. The ideal is to design and implement a structure and processes that contain the right incentives, people, checks and balances so that occasional observations rather than constant in-person scrutiny would be sufficient.

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?

Yes. The professional disciplines of the staff should be largely the same as required and utilized in board membership. The ability to analyze, explain, and write clearly is extremely important in staff members. In addition, it would be good to look for ways to continue to increase the use of technology to enhance the work of the board and staff. Making greater use of online discussions and collaboration as well as the present conference call activities and face to face interactions can enhance both communication and efficiency. Online interactions could also serve to facilitate occasional ad hoc participation of stakeholders in the standards process and/or supply other resources to a project when needed.

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

Yes. Having a permanent staff employed and paid by the board is the best model for building both commitment and capability in the board's work and for promoting independence in thought and action..

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

No doubt there are, as in any organization, continuous improvement is desirable. However, I do not have any additional suggestions in this response. The major issues discussed in the Consultation Paper and the responses it engenders will likely identify additional issues and potential changes needed and others may become evident over time.

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 (eg independent approval of the budget by the PIOB, providing the funds to a separate foundation or the PIOB which would distribute the funds)?

Checks and balances that create a non-voluntary funding process are the strongest form of supporting both capability and independence in audit standard setting. Until such a time as this ideal can be achieved, ideally funding should flow from the funding sources to the PIOB or an associated foundation.

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?

I believe that the audit profession (practitioners and firms that do audits) and users of audited financial statements (both investors and the companies that prepare such audited statements) ideally should ALL contribute to the cost of developing standards for audits. It appears that the best way to do this is through a levy that supports the technical work and oversight involved, applied to audit firms and audit professional organizations for now, and imposed upon audited companies and others in the future after appropriate methodologies and agreements have been developed. For reasons of planning and stability, levy periods should be greater than one year at a time, so perhaps two or three year periods should be utilized to cover reasonable project life cycles. (While today's

project cycles are often much longer, ideally enhancements in standard setting approach and methodology could bring the intervals down over time.)

Audits have a very well defined and important role in the capital markets and deserve fully dedicated attention and resources. The standard setting for audits needs to be carried out by an organization that is both independent and seen to be independent. The standard setting for auditors furthermore should produce standards that improve audit performance and address risks in audit firms as well as in audited entities.

It would appear that a single standard setting board located outside of IFAC would be the strongest and most desirable approach for achieving high quality audit and assurance and ethics and independence standards set in the public interest. There are reasons of both appearance and substance that argue for such a move. However, such a move would have major impacts on the resourcing and funding of both standard setting and IFAC's other public interest activities.

The challenge of supporting the development and capabilities and worldwide services of the global accounting profession looms large and becomes more complicated if the current standard setting is moved out of the umbrella of the IFAC organization. Improving financial management and accountability in organizations of all types, including public and private companies large and small, non-profit entities, national and local governments and other types of entities, is unquestionably desirable and is also a public need as well as a public good. Professional accountants play an important and necessary role in endeavors that encompass a huge area of both public and private interest. Improving financial management and accountability will be a never ending and Herculean task. It is unclear how the numerous types of global capability and accountability efforts involved could realistically be organized and funded if they were placed outside of a professional body that also includes a prominent standard-setting function to attract both attention and resources.. It is also unclear how standard setting could be funded if totally moved outside of IFAC.

It is important to address the set of needs and goals applying to audits and audit standards, and assurance and ethics standards, without creating adverse effects in the execution of other non-audit public interest functions and activities. This dilemma merits extensive further study within the Monitoring Group as well as in IFAC. One approach to addressing this need for study might be to develop a set of alternative models for making a greater separation between IFAC and a single independent standard setting board, models that do, and do not, include actual physical separation from the IFAC organization (or perhaps, actual physical separation versus some form of virtual separation). Then it would be somewhat easier to identify ways in which independent standard setting could be funded

and carried out under each model, and how other public interest activities could be funded and carried out.

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

It has often been said that “language influences thought”. Stated another way, the way that an idea is expressed can have a great impact on the perceptions of recipients of the idea and how they react. In the last several years, many of the statements made about the involvement of auditors in the setting of auditing standards have seemed to carry an implicit assumption that such involvement always creates a significant and unacceptable risk of undue influence and must therefore be counteracted with strong procedural measures to ensure that the public interest will be served.

On one hand, there is surely a risk that if auditors are involved in setting their own standards, some might influence the process to their advantage rather than to the benefit of other stakeholders and the public interest, whether intentionally or unintentionally. Human beings are the product of their experience and their own personalities and perceptions, and individuals may operate with varying degrees of self-interest.

On the other hand, it is not unusual or unreasonable for professionals in a technical field to be involved in setting the standards for work in the field, because of the body of knowledge involved and the need to be vigilant and realistic in considering the operating conditions in which the work is done. All professionals want to be subject to and guided by reasonable and workable standards.

With a well-designed structure and process that takes into account human factors and appropriate checks and balances as well as simplified procedural dynamics, it should be possible to create an enhanced system that benefits investors and users of financial statements while freely using the knowledge of auditors, regulators, audit clients and any other stakeholders. Ideally in such a system, the involvement and contributions of auditors can be, and be viewed as being, a public interest benefit rather than an unacceptable risk.

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

Not at this time. This opportunity to comment is appreciated.

Submitted by

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