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By email: MG2017consultation@iosco.org

Mr. Gerben Everts
Chair of The Monitoring Group

Dear Mr. Everts,

Thank you for the opportunity to comment on the Consultation Paper *Strengthening the Governance and Oversight of the International Audit-Related Standard-Setting Boards in the Public Interest*.

My main comment is that the Monitoring Group should provide a definition of the public interest before any reforms take place, and that the Monitoring Group ensures it defines the public interest not as a narrow focus on only one user –financial market users – but instead defines public interest in a much broader way. The standard setter perhaps has taken too narrow of a focus on the public interest in the past: the auditing standards are overwhelmingly those for auditing financial statements with few standards for other audits. But with the standard setter taking a broader view of the public interest, and these considerations over time being reflected in both financial statement and other auditing standards, auditors may also eventually take a broader view, which I suggest will be more successful in achieving the goals of the Monitoring Group.

I offer the following responses to specific questions in the consultation paper. I use the term “auditing” throughout to mean both auditing and assurance and related activities.

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 key areas of concern noted in the consultation paper are adverse effect on stakeholder confidence in standards as a result of a) perception of undue influence by the profession, b) risk that standards are not fully developed in the public interest, and c) relevance and timeliness of standards.

Starting with b) which I think is most important, it is difficult to evaluate because as noted in the paper the “public interest” has not been defined. The paper says that public interest has not been defined because it evolves, but that is not relevant – the key areas of concern are at this point in time, so the public interest accordingly can be defined at this point in time, to serve as criteria to judge whether and to what extent the current public interest is met by the current standard setting model, and proposed changes.

The consultation paper hints at a particular definition of the public interest, particularly on pages 4-5, where in explaining how public interest is captured throughout the standard setting process, there is “supporting the integrity of financial markets” and “proper functioning of the financial system and economic activity.” As a consequence, in the consultation paper the public interest seems to have been, through a chain of equivalences been defined as what is good for financial markets.

With respect to concern a), it is not clear what the concern is with “undue” involvement of the profession. No evidence of undue involvement is provided. If the concern is that the profession, particular the large firms, are too close to management to continue to serve financial markets, then reforms outside auditing standard setting, such as who appoints and remunerates the auditor, should be considered. Or perhaps investors should be encouraged to take some interest in voting who the auditors are, or securities law should require three auditors on the ballot, rather than simply voting “Yes” or “No” for the auditors the Board or management has already selected.

The profession fulfills its function as the “private police force of capitalism” and seems not to have ignored its purpose, and unlikely deviates far from agreement with the Monitoring Group on what constitutes the public interest. The Monitoring Group could more validly argue a concern with the profession’s ability to serve the public interest (as financial markets’ interest) and raise a concern about undue influence if, for example, the profession suddenly became very concerned with issues of public interest such as environmental protection, labour standards, equality and equity, democracy and governance and was undertaking billions of dollars annually in ISAE3000 audits in these or other areas of interest (to any conventional definition of the word “public”). This seems unlikely to occur.

Auditing standards produced to date seem overwhelmingly concerned with audits of financial statements. Standards for other audits such as ISAE3000 are about 80 pages long, compared to hundreds of pages for financial statement audit, demonstrating where the attention of the standard setter has been placed, and that it has not been misplaced.

With respect to concern c), I note the consultation paper explains the genesis of the concern is a number of corporate reporting failures in the early to mid 2000s. It would be helpful to explain more fully why it is the auditing profession that is to blame for these failures. There is no specific evidence provided in the consultation paper that demonstrates the Monitoring Board has clearly ruled out that it was not an accounting problem that led to the failures, or more broadly, whether particular institutional factors

in capital markets led to the failures. Such analysis would help establish whether concern is warranted i.e. that the problem was auditing standards that were not relevant nor timely. We must avoid simply using minor reforms of auditing standard setting as a substitute for (if necessary) reform, and avoid providing support for the argument that the profession's main role is a form of "political insurance" in the event major failures occur: a way for institutions to be seen to be making changes, but the changes are largely irrelevant and do not deal with the systematic problems that led to the failures.

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

An additional supporting principle is the technical correctness of standards. Neither the supporting principles of credible nor relevant as described in the paper express this idea: that the standard-setting process results in standards that are consistent with most advanced thinking on auditing, logically coherent, and theoretically sound.

I agree with the overarching principles. The concern is that what the consultation paper hints is "the public interest" likely has no similarity to any interest any member of the public would define, unless that member was an investor or creditor.

A definition of financial markets as the public interest that auditing standards serve therefore perhaps has compromised independence of the standard setter. The supporting principle noted in the consultation paper that "no individual stakeholder should be able to exert undue influence" is not met if the goal of auditing standard setters is to serve capital market participants.

I suggest that the public interest should be defined as 1) what is of interest to the greatest number of citizens, and 2) the greater number of stakeholders of the organization being audited.

A category of auditors that serves the public interest are supreme audit institutions (SAIs) i.e. state auditors. SAIs act not only for financial markets (especially bond markets) but are responsive to the needs of representatives of the state, and through that, to the needs of citizens. SAIs serve the public interest almost by definition, as public sector auditors, but the auditing standards too often unfortunately provide guidance for listed entities as a "higher" standard and relegate guidance for public sector auditors to application guidance. SAIs audit financial statements, including those prepared in accordance with IFRS and public sector accounting standards. SAIs also audit the performance of entities. Ultimately, what the public is interested in is accountability for performance, not only in a narrow financial sense but also in a broader sense as efficiency, economy, equity, environment and effectiveness. As noted earlier, there are hundreds of pages of auditing

standards for financial statements and 80 pages or so for standards public sector auditors use for audits other than financial statements. *So auditing standard setting has evolved to the curious position where it says it is in the public interest, yet most of its standards are for a narrow financial markets interest, and almost none of its standards are for auditors that most generally serve the public interest.*

This is not to say that SAIs should be within the scope of the Monitoring Group, even though PIOB has discussed governance of IPSASB and a Public Interest Committee for IPSASB was recently formed. SAIs are as sovereign as their states. Nevertheless, the International Standards on Auditing (ISAs) are used as the basis for the standards for audits in the public sector, either by auditors that follow the International Standards of Supreme Audit Institutions or by public sector auditors that follow the standards their national auditing standard-setters adopt, which may be the ISAs. My point in raising SAIs is for comparison and reflection by the Monitoring Group that there are possibilities for auditors to serve a public interest beyond financial markets, and that auditors that serve broader public interests may, perhaps counterintuitively, be the best at also serving the interests of financial markets. The reason is simple: a broader public interest preserves auditor objectivity because no particular interests are privileged. Their incentives are to do the best audits that best serve the public, and their incentives are not distorted by factors such as profitability, revenue growth, re-appointment pressures, litigation, etc.

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 definition of public interest is crucial to assessing whether a standard has been developed to represent the public interest. One additional principle would be that the standards include explanation, tied to their objective, of how the public interest is served by the auditor meeting the objective of the standard. This may be done as a paragraph accompanying each “the objectives of the auditor are...” paragraph within each audit standard.

Also, standards should be subject to post-implementation reviews that systematically collect global data to determine whether the standard has resulted in improvement in meeting the public interest. Notwithstanding many audit standards are interrelated, there is value in post-implementation reviews of all changes made to standards to determine whether they are having their desired effect... i.e. the standards have changed audit practice to better serve the public interest.

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.**

The discussion paper proposes a single board combining ethics and audit standards. Intuitively, because audit quality is unobservable to the user, ethical standards should be integral to, and seen as inseparable from, the more “technical” audit standards. Perhaps technical standards could in application guidance warn of potential pitfalls or ethical traps auditors may be exposed to while attempting to meet the objective of each standard.

However, the paper states (p. 11) that one board does not mean a single set of standards covering ethics and technical matters for auditors. It is not explained why this is the case. But if that is not the case, then separate boards are likely desirable, because the scope of ethics i.e. codes of conduct of auditors includes many issues not relevant to either a specific audit nor the quality control at an audit firm, such as ethical advertising or issues relating to fees, which may seem out of place in a technical set of audit standards, and may distract a unitary board from important technical audit issues. There may also be ethical issues that are much more relevant to accounting professionals in business than auditors, and a separate board can more effectively focus on appropriate ethical standards for accountants in business.

Auditing standards may be correctly designed but due to lack of competence, integrity or due care they are not followed. Post implementation reviews of whether a standard met the public interest, or root cause investigations of failures of auditors to maintain or preserve the public interest, may indicate the cause was related to deficiencies in the technical practice of auditing, or ethics, or both. I suspect that rarely are they “both” (but the Monitoring Group should collect data) and so separate boards are warranted.

5) 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?

I agree responsibility for development and adaption of education standards be with IFAC. However, consider whether responsibility for education of other stakeholders about the role of auditing should be with the audit standard setter.

The paper notes that IFAC runs a compliance program and that after reforms “IFAC will continue to play an important role...” That does not necessarily mean that IFAC will run a compliance program. It may be that a new separate board – a compliance board– under oversight of PIOB is warranted. The board would assess results of practice inspections of audit quality globally and serve as detection system, and perhaps early warning system, to the other boards, if supported by data from global practice inspection entities. A separate board would help counter challenges regarding independence of compliance assessment from the profession itself, if members are drawn mostly or entirely from outside the profession, perhaps judges or adjudicators. (It may eventually have resources to hold hearings in public, become a type of “audit court” to develop precedent on what

are appropriate actions for auditors to take in specific circumstances, which can inform practice and future standards, as the ultimate appeal level of more local professional organizations practice inspection.) As well, findings from compliance programs are often a source to identify necessary improvements in standards. An auditor compliance board could also provide commentary to PIOB on whether the Board's post-implementation assessments of whether standards met the public interest were fair.

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

Yes. However, the paper does not discuss the crucial matter – whether responsibility for investigation and enforcement of violations of ethical standards for professional accountants in business should be responsibility of IFAC. Powers of investigation, arrest, trial and incarceration are left to judicial systems.

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.

As noted in responses to later questions, reforms of Monitoring Group membership may be necessary to meet the public interest.

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?

No, the Board should not be more strategic in nature, once the public interest is appropriate defined. The Board's role is to ensure that the global set of standards is at all times the best set of standards to serve the public interest; this is the most strategic goal it can have and should not lose any focus on that.

Of course, the Board may need to set priorities from time to time, informed in some way by analysis of trends and failures and best practices, but it is not clear what strategic decisions the Board would need to make. An effective PIOB should be able to provide meaningful input into the Board's priorities and workplans.

Board members should be remunerated. Remunerating Board members may require severing existing employment ties, which would focus the member on their Board role, and reduces the risk that the Board member considers their privilege of serving the public interest on the body that sets global auditing standards as secondary to their "real job" that they have retained. A condition of serving on the Board would be independence: that the Board member has no other board memberships nor "revolving door" type of post-board tenure agreements that would beholden the board member to whatever stakeholder employed them last and would employ them after their term.

Renumerating Board members, with strong breaks in employment, may reduce the pool of candidates for Board members, especially if the Board cannot pay equal to what the member is “worth” in the market. But it is among the most powerful tests of willingness to serve. Serving on the highest determination of auditing standards should be done from a willingness to serve the public rather than for reasons of compensation.

Board member selection from a broad constituency is important.

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

I agree. Some formula for majority such as 12/15 for approval prevents a special interest from effectively having a veto over a standard that serves the public interest.

Board deliberations should be in public, broadcast to anyone, with votes as well done in public. Consideration should be given to whether basis for conclusions should include reasons board members dissented; this gives insight into due process.

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?

All Board members should be full-time. Staggered terms are appropriate, such that in any given year 1/4th of the members are new. It matters little whether the Board is 12 or 16 members.

The Board is mainly a technical Board and therefore representation from the auditing profession is desirable and necessary. The majority of the Board should therefore be from the auditing profession, which would practically mean large firms, small firms and practitioners. Representation from national auditing standards setters is also desirable. Consideration should be also given to representation from INTOSAI members, academia, accountants in businesses or not-for-profits or governments, and members of the public, perhaps chosen if a particular public interest was on the Board’s 3-5 year work plan.

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

Skills should be that they understand what the public interest is, can articulate how the Board serves it, and have a high degree of technical skill and experience in auditing.

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?

I agree.

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

I agree.

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

I agree.

15) Do you agree with the role and responsibilities of the PIOB as set out in this consultation? Should the PIOB be able to veto the adoption of a standard, or challenge the technical judgements made by the board in developing or revising standards? Are there further responsibilities that should be assigned to the PIOB to ensure that standards are set in the public interest?

The risk with PIOB being able to veto the adoption of a standard or challenge technical judgments made by the Board is that PIOB effectively becomes a second board. Limiting PIOB to being able to assess whether the Board adhered to established due process is a more effective oversight process. This adherence should be communicated prior to issuance of a standard, with an established process for the Board being able to respond to any PIOB concerns.

The PIOB's mandate of "to increase confidence of investors and others that the public interest activities of IFAC are properly responsive to the public interest" should be reconsidered because it defines the public interest too narrowly as the interests of investors.

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

No. Effective two way communication between IFAC and PIOB is best achieved by IFAC representation on PIOB. It does little to deal with the "undue influence of the profession" concern however this could be achieved by making IFAC a non-voting member, but this is likely not necessary.

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, given its oversight role, does not need to have the same technical skills and experience as the Board. The PIOB importantly has to assess whether the Board has adhered to due process. Therefore, the attributes of PIOB members should be that they are external to the profession and come from stakeholders that auditors serve when they serve the public interest. They should be drawn from the Monitoring Group members.

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?

The consultation paper notes that reforms of MG may occur later. The MG's composition reflects a public interest defined more closely to that of capital markets (banks, insurance, investors). This is probably not a conception of the public interest that would benefit most citizens of the globe. Therefore, an important reform will be to open the MG composition to diverse users of audits, including audits of general-purpose financial statements. The list of users can be found in conceptual frameworks of accounting, either accounting for business or not for profits or governments, and includes not only banks, insurance and investors but also includes, for example, management, employees/labour, customers, suppliers, the state and citizens. Auditing need not be limited to auditing of accounting (financial statements or otherwise) but also auditing that is directed at broader topics, such as auditing contemplated by ISAE3000, and within financial statement audits, audit quality may be improved by focus on the needs of other users, not only financial market participants. This greatly expands the notion of what is audited by the standards within the remit of Board and arrives at what I suggest earlier is the actual "public interest" that needs to be served. Users of ISAE3000 include those specific users mentioned earlier, as well as many others.

In other words, the PIOB and Monitor Group's present composition mainly tied to financial markets users is perhaps much too narrow of a public interest. Whatever are the global representative institutions of these other users groups should nominate representatives to be members on the reformed Monitoring Group and PIOB. This representation would expand the memberships of both, and also make both representative of the public interest.

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?

It should oversee the work of other standard-setting Boards. However, as long as the public interest is defined narrowly as the interests of financial markets, the PIOB should not have oversight over the public sector standard-setting boards.

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?

I agree, given the changes in Monitoring Group composition noted in question 18.

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?

I agree. The skills should be similar to those of Board members.

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

I agree. I do not think that it is a career path from junior to senior technical staff to Board member. The rotation of Board members preserves an ongoing relevance, with fresh thinking constantly brought in, with new perspectives.

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

The Board should hold its deliberations in public, broadcast via video over the web, translated into official languages of the United Nations.

The Board needs to more strongly encourage public participation in standard setting due process, in particular responses to exposure drafts.

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)?

The vast majority of the benefits of the Board as presently constituted accrue to financial market participants; therefore financial market participants should pay. A levy on stock market transactions could be applied by all recognized stock exchanges to fund the Board. The members of the Monitoring Group have precise data to calculate an appropriate levy, but given the substantial number of stock traders per day globally, it should be possible to implement a levy per stock market buy/sell transaction (not per

share) that adequately funds the Board, with a full complement of research staff, with salaries higher than they would make in their next best alternative employment. If placed within a separate foundation, which then funded the Board, any risk to independence would be reduced.

If the definition of public interest broadens to include other stakeholders, other means of funding from those stakeholders could be investigated.

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?

No contractual levy is necessary; as discussed in response to question 24, a levy on stock market buy/sell transactions would be sufficient, and efficient to collect.

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

It is crucial the Monitoring Group be precise and descriptive in its definition of the “public interest.” If the Monitoring Group intends for the definition to be limited to the needs of financial capital, then it should plainly state it.

The Monitoring Group should ensure it has adequate support for implementation of reforms before proceeding with any reforms. A reasonable measure of adequate support is both the quantity and nature of responses received to the consultation paper. Substantial reforms such as those proposed require clear support to proceed. Therefore I suggest that the Monitoring Group measure whether it has received substantial support with a fairly “high bar” i.e. that it has receive substantially more than the normal responses an IAASB exposure draft would receive (i.e. hundreds of responses) and that a high majority (12/15ths) of those responses support reform. Absent that, it is likely that the Monitoring Group lacks support to proceed.

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

The Monitoring Group has opportunity for reform of the auditing profession that is transformational. I am not sure, and the consultation paper has not provided evidence of, whether the problem is with the auditing standards themselves (a problem the Board can solve) or instead with any of the following:

- institutional arrangements (such as who pays the auditor or how auditors are selected)
- accounting standards (especially the attempt to have shareholders’ equity somehow proxy for market value, in particular the move away from historical cost accounting towards fair values)
- ethics of accountants in business (preparers of what is audited)

- inherent instabilities in financial markets, perhaps made worse by high speed trading and derivatives, or
- inadequate regulation and oversight of financial market participants.

Financial markets are crucially important. But financial markets are not equal to society nor the public interest. It is likely a mistake for the Monitoring Group to reform auditing standard setting with a greater focus on the public interest as the interest of financial markets and expect better auditing. Auditing is already too focused on financial markets and while some categories of auditors, such as public sector auditors, have advanced past this in new directions, the Monitoring Group should pause and deeply consider that it may have been too much focus on financial markets by auditors that led to the past crisis, so it cannot be even more focus on financial markets by auditors that will prevent the next one.

It seems counterintuitive that focusing auditors on interests other than financial markets would improve their ability to serve financial markets as well, but I believe it is largely because it preserves, promotes and enhances the most important quality of auditors – their objectivity. Serving many interests beyond the special interests of financial markets in effect serves general interests i.e. public interest.

The Monitoring Group has an opportunity to reorient auditing into what it fundamentally is – rendering an objective opinion on something to a third party, based on evidence and judgment.

Thank you for the opportunity to comment.

Sincerely,

Wayne Morgan PhD CPA CA CISA