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Dear Sirs

**Strengthening the governance and oversight of the International audit-related standard-setting boards in the public interest.**

I am pleased that the Monitoring Group (MG) has published a Consultation Paper on the topic of strengthening the governance and oversight of the international audit-related standard-setting boards. While, over the years, IAASB and IESBA has done some good work I believe that this is a good time to reconsider arrangements for setting standards relating to auditing.

That said, the changes outlined in the Consultation Paper are very wide ranging and there is a considerable risk involved in wholesale change. The Consultation Paper suggests a phased approach which I think is very sensible. My suggested priorities are:

1. Expanding the role for the PIOB alongside, I assume, increasing the quantity and quality of its resources,
2. Appointing some full-time Board members, and
3. Ensuring that those involved in independent audit quality monitoring activities (most probably through IFIAR) are directly involved in the standard setting process.

If there is to be a major reform to the way that auditing related standards are set I think there are three very important issues that need further consideration by the MG. These are:

- **Integration within the IASB structure.** While there has been some liaison between IASB and IAASB in recent years I feel more could be achieved if the two bodies are integrated within the same structure. This is especially important as the accounting framework becomes increasingly more judgemental. Not only does the IASB need to be sure that its proposals are auditable but both preparers and auditors need to have a common understanding of how to make the necessary judgements. A closer working relationship between IASB and IAASB would improve the quality of both sets of standards and adoption of the same oversight arrangements should result in cost savings and global acceptability. Being part of a relatively large, well established, staff structure would also provide the necessary platform to recruit the necessary technical staff to support the MG's aspirations.
- **Audit quality.** While auditing and ethical standards have value they are only part of a wider concept of audit quality. More regulatory attention needs to be given to the broader concept of audit quality. In my view auditing standards have become overly process driven and the core needs for auditor objectivity and scepticism need more attention. While more words can be written on more sheets of paper, achieving real improvements in these areas

will need changes to audit firm culture, training and the interrelationship between auditors and audit committees. To achieve a step change in performance any new regulatory framework needs to address audit quality in the round.

- **Adoption processes.** IAASB and IESBA standards have been adopted by over 100 countries, this has been driven, in part, by the requirements imposed on IFAC Member Bodies. It is unclear to me how the 'new' standards will be mandated especially if they are intended to apply to audits of all sizes and other assurance activities. That said, even if the MG is successful it is only likely to achieve the same coverage as has already been achieved by IFAC. The real challenge will be to extend coverage and, the US is of particular importance. While it would be over-simplistic to think that the PCAOB will use the 'new standards' a clear path for greater convergence with the US needs to be planned.

The MG is right that there is a perception problem with the current funding arrangements. However, over the years I have not seen an actual threat to the independence of IAASB's work because of this although it might have limited the funds available to support reform to IAASB's operations. Implementation of a number of the MG proposals will require a substantial increase in the absolute amount of funding required, especially if Board Members are to be paid and the quantity / quality of the technical staff is to be strengthened. I am disappointed that the MG has not already established independent and sustainable funding arrangements. The possibility of imposing a levy on audit firms is floated in the Consultation Paper but I doubt that this would change perceptions. It would however necessitate a very costly collection process - there are better things to spend limited funds on.

I also urge the MG not to sacrifice the need for detailed knowledge of auditing when setting standards at the altar of perceptions of independence. The PIOB can do much to ensure that the Board(s) acts independently, it can not compensate for incompetence. To date relevant knowledge and experience has been provided through about nine experienced auditors being members of IAASB with support from technical advisors. The Consultation Paper suggests that in the future the involvement of practicing auditors will be significantly reduced. This is very risky. While in theory high quality technical staff can be hired to fill the knowledge gap it is far from clear to me that there are people with the necessary skills, knowledge and especially experience who will want to work for the new standard setter. For this reason, I favour some Board members being made full-time, provided that these individuals have themselves a detailed understanding of auditing. There also needs to be more auditing expertise in the PIOB.

I hope my comments will be of interest to the MG. They are based on having been the first Executive Director of the UK's Auditing Practices Board between 1996 and 2010. The APB was the first element of UK independent audit regulation and faced many of the issues covered by the Consultation Paper. Between 2000 and 2013, I was also heavily involved with the work of IAASB and, to a lesser extent, IESBA. During this time I led the development of IAASB's Audit Quality Framework which I commend to you. My comments therefore reflect two decades of experience in this area. I would be very happy to discuss my views in more detail if that was to be considered beneficial.

Yours faithfully

JEC Grant

## Response to MG questions

### 1. Introductory questions

Q1	While I am sure the Consultation Paper correctly identifies ‘perceptions’ about IAASB / IESBA lacking independence, I believe that the IAASB (and I am sure the IESBA) has always tried to make the right decisions in the public interest. Great care needs to be taken to avoid action taken to try to address perceptions about lack of independence reducing the efficiency and effectiveness of the Board(s). In particular I am concerned about a significant reduction in auditor involvement in the standard setting process.
Q2	I would add ‘ <b>understandable</b> ’ as a supporting principle There are several dimensions to understandability. The standards need to be clearly written. This may seem axiomatic but it is not. Language used is sometimes over-complicated, especially given that translation is needed. The Board(s) also need to undertake support activities to ensure that the standards are consistently understood globally.
Q3	<p>The IAASB’s Audit Quality Framework may assist the MG develop its Framework. It defines ‘<b>a quality audit</b>’ as one where the engagement team:</p> <ul style="list-style-type: none"><li>• Exhibited appropriate values, ethics and attitudes,</li><li>• Was sufficiently knowledgeable skilled and experienced and had sufficient time allocated to perform the work,</li><li>• Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards,</li><li>• Provided useful and timely audit reports, and</li><li>• Interacted appropriately with relevant stakeholders.</li></ul> <p>The IAASB’s Audit Quality Framework also defines ‘<b>audit quality</b>’ as being the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis.</p>

### 2. Current number of Boards and their remits

Q4	In the medium term I believe it would be desirable to combine the work on auditing standards with ethical standards for auditors. There are strong links between auditing and ethical standards and the same underlying knowledge of auditing is required by Board members. In the UK the Auditing Practices Board was given responsibility for both sets of standards in 2002 and this has worked well. However, in a phased approach I am not sure that combining the Boards is a top priority.
Q5	I believe there would be benefit in focusing the entire regulatory framework on ‘audit quality’ rather than just standards setting. Training is an important input to audit quality. While I have personally never believed that the educational standards issued by IFAC have had much value, audit firms providing proper training is vital. More thought needs to be given to how education / training is dealt with under the new regime as well as other elements of audit quality.
Q6	In my view the new Board(s) need not be involved in the development and adoption of ethical standards for professional accountants in business. While IFAC may wish to retain this role, I believe other regulators should be encouraged to do more. For example, the OECD should be encouraged to deal with the behavioural aspects of corporate

	governance and the IFRS Foundation should deal with ethics as it relates to accounts preparers. The MG has an important role to play in stimulating such activity.
Q7	<p>If there is to be a major reform to the way that auditing related standards are set I think there are three very important issues that need further consideration by the MG. These are:</p> <ul style="list-style-type: none"> <li>• <b>Integration within the IASB structure.</b> While there has been some liaison between IASB and IAASB in recent years I feel more could be achieved if the two bodies are integrated within the same structure. This is especially important as the accounting framework becomes increasingly more judgemental. Not only does the IASB need to be sure that its proposals are auditable but both preparers and auditors need to have a common understanding of how to make the necessary judgements. A closer working relationship between IASB and IAASB would improve the quality of both sets of standards and adoption of the same oversight arrangements should result in cost savings and global acceptability. Being part of a relatively large, well established, staff structure would also provide the necessary platform to recruit the necessary technical staff to support the MG's aspirations.</li> <li>• <b>Audit quality.</b> While auditing and ethical standards have value they are only part of a wider concept of audit quality. More regulatory attention needs to be given to the broader concept of audit quality. In my view auditing standards have become overly process driven and the core needs for auditor objectivity and scepticism need more attention. While more words can be written on more sheets of paper, achieving real improvements in these areas will need changes to audit firm culture, training and the interrelationship between auditors and audit committees. To achieve a step change in performance any new regulatory framework needs to address audit quality in the round.</li> <li>• <b>Adoption processes.</b> IAASB and IESBA standards have been adopted by over 100 countries, this has been driven, in part, by the requirements imposed on IFAC Member Bodies. It is unclear to me how the 'new' standards will be mandated especially if they are intended to apply to audits of all sizes and other assurance activities. That said, even if the MG is successful it is only likely to achieve the same coverage as has already been achieved by IFAC. The real challenge will be to extend coverage and, the US is of particular importance. While it would be over-simplistic to think that the PCAOB will use the 'new standards' a clear path for greater convergence with the US needs to be planned.</li> </ul>

### 3. Current composition and reform

Q8	<p>A more strategic approach should be encouraged but this should not be allowed to dilute Board members' detailed understanding of auditing. A 'high level' approach may also be difficult to achieve in practice. Based on my experience many of the issues with crafting auditing standards only emerge through discussion of the detail. I can recall many examples of Board members changing their positions after thorough debate of what initially appeared to be an obscure point of detail.</p> <p>To increase operating effectiveness, I think the Board(s) should involve some full-time members who should be remunerated. To achieve harmony, I would suggest that part-time members should also be remunerated for their time.</p>
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Q9	Yes, a significant majority of say 75% should be sufficient. However, this may not speed up the development process much. As with the IAASB, in practice a chair is likely to wish to seek the unanimous support of the Board.
Q10	<p>I support the idea of a multi-stakeholder Board(s) and am pleased that independent audit regulators will be represented as this should avoid them generating their own, second tier, standards. I also believe that audit committees should be represented as they can have a significant influence on audit quality.</p> <p>While a smaller Board (of say 12) may work I fear it will be difficult to achieve sufficient spread of geographical and user groups interests without significantly diluting the underlying knowledge of auditing which is fundamental to developing high quality auditing standards. This can however be addressed by appointing some full-time Board members provided they have the underlying knowledge of auditing. This should lead to greater operational efficiency.</p>
Q11	It is very important that the MG do not neglect the need for many Board members to have a good understanding of auditing. To create effective auditing standards, there is a need for a profound understanding of current auditing and the legal and technical environment in which it is performed.
Q12	In the past the CAG has been a useful way to obtain views from a wide range of user groups and geographical interests and this helps to provide credibility for the final standards.
Q13	More thought needs to be given to how standard setting projects are in practice to be undertaken in the public interest. I fear that the existence of a public interest framework, by itself, will not be enough. Lacking the transparency that is achieved in the Board's work there is a danger that task force activity can provide an opportunity for certain groups to exercise undue influence. With some full-time Board members and a stronger technical support team, it may be that working parties can be dispensed with.

#### 4. Nomination process

Q14	Yes. The nomination process should be administered solely by the PIOB. To do this effectively the PIOB will require additional resources.
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#### 5. Oversight

Q15	<p>I think that reform of the PIOB should be the top priority of the MG reform process. While I recognise that historically the PIOB remit was focussed on the standard setting process, I have been very disappointed that, over the years, the PIOB has not done more to try to improve audit quality holistically. In part I suspect that the PIOB membership has not involved people with sufficient current knowledge of auditing. Provided that the right people are appointed I support the MG's proposals to expand the role of the PIOB. Important activities for it will be challenging the Board(s) strategy, appointing members and ensuring the work is adequately funded.</p>
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	Provided that the standard setting Board(s) is representative of user groups and has followed due process I am not sure on what basis the PIOB would decide to take a different view on matters of substance as they do not have the time or expertise to write standards. In practice, of course, the PIOB can be expected to ask the Board(s) to 'think again' about important issues but they should not ultimately be allowed a veto.
Q16	The PIOB is currently largely made up of regulators rather than auditors. Just as standard setting needs relevant knowledge of auditing so does the PIOB. In my experience, the maxim of a 'poacher turned gamekeeper' works in practice. Untrained gamekeepers do not know where to point the gun! While specific representation from IFAC is not needed, knowledge of auditing is. In my view this is best provided from practicing audit partners or recently retired audit partners that have worked at a senior level in the profession.
Q17	As under Q16 it is essential that a number of PIOB members have recent direct knowledge of auditing. It also seems to me essential that Audit Regulators are represented on PIOB.
Q18	PIOB members should be identified through an open call for nominations and selected by the MG. It is unclear to me why nominations should be limited to MG member organisations indeed this would appear to exclude auditor involvement. As noted under Q16 I believe that it is essential that there should be some auditor involvement in the PIOB.
Q19	The PIOB should focus on audit quality, it does not seem to me to be necessary for it to be involved in ethical issues for accountants in business (this might be a valid role for the OECD / IFRS Foundation). Training is however necessary for the proper implementation of auditing and ethical standards and, as demonstrated by IAASB's Audit Quality Framework, this is an important audit quality input. The MG needs to consider how best to focus the PIOB on audit quality including how best to ensure that adequate training in the application of the standards is provided in practice.

## 5. Monitoring Group

Q20	As mentioned elsewhere, in a perfect world, I believe that audit standard setting should be combined with the setting of accounting standards. If this was done then the Board(s) oversight and MG's activities 'overseeing the oversight' could also be integrated into the IASB structure. This 'perfect position' might take some time to achieve. In the short term, and on the basis that audit regulators are fully involved, I support the MG continuing its role.
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## 6. Staffing

Q21	<p>In theory expanding the technical staff sounds a good way to move forward but I doubt that this will work in practice. Staffing a standard setting activity is a challenge as:</p> <ul style="list-style-type: none"> <li>• It is difficult to recruit senior staff with the right knowledge and experience gained from auditing. What is needed is partner experience but ex-partners are hard to recruit. For other technical staff salaries are generally low and the need to comply with detailed due process requirements can make the role frustrating.</li> </ul>
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	<ul style="list-style-type: none"> <li>• A good understanding of auditing is a prerequisite for writing high quality auditing standards but is not sufficient. Additional skills are needed for writing auditing standards and even for the 'right sort of person' these take time to develop.</li> <li>• A stand-alone standard setting activity is unlikely to have the critical mass to support the right environment for staff and career development opportunities are limited.</li> <li>• While it is important to have geographical diversity in the staff team this leads to recruitment problems and inefficiency.</li> </ul> <p>Based on my experience I firmly believe that the best way forward is to make some Board members full-time. Provided that these individuals have in-depth knowledge of auditing they can lead projects and mentor the other technical staff.</p>
Q22	<p>Using seconded staff is a possible approach but there will be inefficiencies associated with using them and, perhaps more importantly, independence issues especially if the Board is reliant on their specialist expertise. The risks would be significantly reduced if there was a cadre of full-time Board members supervising their work.</p>

## 7. Process

Q23	<p>The appointment of some full-time Board members and a strengthening of the technical staff should lead to some improvement in the efficiency of the standard setting process. However, the potential for significant improvement is limited by the need for due process and because of the nature of the current standards.</p> <ul style="list-style-type: none"> <li>• <u>Due process</u>: The current working practices have evolved in response to regulatory and PIOB pressure and the understandable need to demonstrate due process, transparency and responsiveness. It will be difficult to significantly change working practices whilst, at the same time, complying with best practice in standard setting.</li> <li>• <u>Nature of standards</u>: Part of the problem of operating inefficiency results from the nature of the current standards. The current ISAs are highly interconnected and, to my mind, over-engineered. They are also optimistically aimed at audits of all sizes of entity (large listed, small listed and non-listed) and all types of industry (banking, manufacturing, IT etc). Because of their universal nature, consultation drafts receive push back from practitioners involved in smaller audits and the final standards become increasingly complex.</li> </ul> <p>While I would like there to be reconsideration of the nature of the standards to make them more principles based I doubt that this would be acceptable to audit regulators or fit with the need to grandfather the existing standards. Indeed, as audit regulators become more involved in writing standards I think they will become more and more specific and 'rules based'. This will cause a major problem for auditors of smaller entities. The only options I can see are:</p> <p>(1) limiting the scope of the Board(s) standards to Listed Company and Other PIE audits, or  (2) Instructing the Board(s) to issue a separate set of standards for smaller audits.</p>
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## 8. Funding

Q24	<p>Yes, I do believe that checks and balances can be put in place to deal with the independence threat. In particular the PIOB can usefully be given responsibility for the oversight of funding. However, the problem of substance is where the probably significant increase in funding for the new arrangements will come from. The Consultation Paper identifies challenges in moving to a situation where the Board and PIOB are less reliant on funding from the accountancy profession. However, unless this is achieved any change is likely to be merely cosmetic. A levy on audit firms is suggested but this would give rise to a very complex and costly collection process. Such an approach would also not mean that the costs are fairly shared between users, preparers and auditors. Unless an equitable approach can be designed I doubt that that it is worth changing the current approach. A new system should only be established if IFAC refuses to fund the additional costs that the PIOB concludes will be needed.</p>
Q25	<p>No. A levy system would be costly to administer and give rise to many practical difficulties. More importantly I do not think It would overcome the perception problem linked to the current funding arrangements.</p>
Q26	<p>The future location of the new Board(s) is not discussed in the Consultation Paper but this is a key issue. It is likely to take much time to decide on a new location and this will delay the recruitment of full-time Board members and technical staff. A new location would also likely involve much cost and long-term financial commitments. These were major problems when the APB was made independent back in 2000. Avoiding this issue, at least in the short term, is another reason why I believe it is best to pursue as much reform as is possible within the current structure.</p>
Q27	<p>No, I think the MG already has a very long list of things to think about!</p>