Homefield
Walpole Avenue
Chipstead
Surrey
CR5 3PN
01737557453

Dear Sirs,

As a former member of IAASB I have read the ITC 'Enhancing Audit Quality in The Public Interest' with great interest, I also attended the forum, held in London to discuss it on 5 April 2016.

There are many issues that IAASB is seeking to address in its current project, many of them are complex and some have been extensively debated in the past. Moving the ITC forward into changes to auditing standards is therefore a daunting task and it seems likely to me that revisions to the standards may take many years to complete which would be unfortunate.

There is also a danger that in seeking to address some of the 'varied and complex scenarios that arise today' the standards will become much more complex and prescriptive. I have always believed that principles based standards are what are needed to encourage a 'thinking audit' and thereby make auditing a motivating activity for auditors and facilitate the profession in recruiting and retaining talented partners and staff.

I would therefore encourage IAASB as far as it possibly can to streamline the project and to try to respond to the issues by modifying existing requirements to make them more principles based rather than adding more and more requirements to address current 'varied and complex scenarios'. As the saying goes 'less can be more'.

In the attachment I have responded only to those questions where I think I might have a useful perspective. I am conscious that some of my suggestions call for additional requirements and fear that this may seem inconsistent with my call for retaining principles based standards. I am comforted that many of my suggestions relate to new requirements in ISQC1 which applies to firms rather than individuals and where the need for principles is perhaps less acute.

I wish the IAASB good heart and fortune as it strives in its important work of improving audit quality on a global basis.

Yours faithfully

JEC Grant

Responses to selected questions in the ITC

General questions

G1	**Principles based standards**
	IAASB includes as one of its objectives in the public interest 'keeping ISAs fit for purpose' and suggests that the ISAs need to promote audit quality at the engagement level in the varied and complex scenarios that arise today.
	This must be right but there may be different ways in 'keeping ISAs fit for purpose'. One way may be to focus on a relatively small number of principles and to continue to refine them in the light of current needs. Another may be to add more and more requirements and guidance to address particular new issues.
	I would encourage IAASB to try to keep its standards as principles based as it possibly can. There is a danger that ever more specific standards / guidance to address these 'varied and complex scenarios' will result in far more detailed procedural standards that:
	• Will be hard to understand,
	• Will demotivate partners and staff by making audits even more of a compliance exercise than it has become,
	• Will not apply to all circumstances (eg to audits of SMEs), and
	• Will need ever increasing effort to keep them current.
G3	Over recent decade firms and regulators have overly focused on the process of audit. The recently published FRC / ICAS paper on Skills, competencies and the sustainability of the modern audit by Professor Stuart Turley et al. demonstrates some of the dangers of this. The time has come to focus more on the people who do the audits. IAASB can assist this with some additional material in ISQC1 but needs to avoid increasing still further the level of prescription in the ISAs.

Professional scepticism

PS1	The definition of professional scepticism as being 'an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence' has remained unchanged for many years. Since it was first developed audits have become much more risk driven. One of the problems with the current definition is that it does not help define the appropriate mindset for risk assessment in accordance with ISA 315. At the London forum a view was advanced that the proper mindset was a 'neutral' one – I cannot agree with this. Auditors must, to some degree, doubt management and the reliability of the draft financial statements if they are to properly identify audit risks and gather sufficient audit evidence. Some academics have termed this mind set 'reasonable doubt'.
PS2	I agree with the analysis given in paragraph 30 of the ITC. I suspect that firms do not do enough to encourage audit staff to apply scepticism indeed the reverse probably applies in practice. Audit firms put their staff under significant pressure to meet budgets and to complete audits to demanding timetables – audit staff respond by doing the minimum work possible. Companies often make the problem worse by seeking to minimise audit fees and often by advancing reporting deadlines.

PS3	As noted in paragraph 30 I think it is very important that partners and managers find the time to provide less experienced staff with coaching / on the job training. As described in the IAASB's own Audit Quality Framework this is one of the main ways that staff learn how to be sceptical. This issue needs emphasis in ISQC1, it could also be usefully explored by IAESB.
PS4	There is a limit to what can be done in standards to achieve behavioural change. That said the current focus on revision of to ISAs 220 and, in particular, ISQC1 gives IAASB a good opportunity to try to increase the degree of scepticism applied in practice. If the root causes of the problem are attitudes and work pressure within the audit firms, ISQC1 can help by mandating actions such as: • Requiring the EQCR review to focus on scepticism, • Building more in mentoring / coaching and the appraisal process, • Specifying areas of audit quality (such as scepticism) to be used in staff appraisals, and • Specifying areas of audit quality (such as mentoring / coaching) to be used in partner and manager appraisals. Another way is to mandate audit steps in area specific ISAs that force scepticism to be applied in practice. This approach was taken by IAASB in previous years in the revision to a number of standards including ISAs 240, 540 and 550. One of the downsides of this approach is, of course, added prescription in the standards.
PS5	Audit committees have an important direct role in witnessing and encouraging the amount of scepticism demonstrated by the external auditors. They also have an indirect role in helping ensure that audit fees give scope for proper scepticism to be applied and perhaps in relaxing reporting timetables.

Quality control

QC1	The ITC suggests that IAASB may be favouring making a significant change to the structure of ISQC1 to embed a QMA approach. It was suggested at the London forum that this might help 'future proof' the standard, change the emphasis from detection to prevention and make the standard more scalable for SMPs. Some of these benefits may be illusionary. I do not believe that the current standard is unduly focused on detection and observe that firms have already had to apply the existing standard for a decade so they should have overcome implementation issues by now. Rather, having to implement a radically different standard is likely to give them new ones! I believe that IAASB should be very cautious in changing too much of the structure and approach of the current ISQC1. ISQC1 has a solid conceptual foundation (being based on the EFQM Excellence Model) and has provided a clear set of quality benchmarks for firms and regulators for over a decade. Encouragingly, some regulators have invested in inspection methodologies based on ISQC1. While I can imagine that ISQC1 could be adapted to apply a risk based approach to quality control I am not convinced that this would result in enhanced audit quality, indeed it might result in some important firm-wide controls being neglected. I also sense that making ISQC1 more risk based would make the standard far more judgemental and therefore difficult for regulators to check that it is being properly applied. This is not to say that improvements should not be made to ISQC1. A number of weaknesses were identified in the ISA Post-implementation Review and the Audit

	Quality Framework project revealed a number of areas in which it could be enhanced. In particular I believe that emphasis should be given to making sure that ISQC1 fully addresses the Knowledge, Skills, Experience and Time attributes in section 1.5 of the Audit Quality Framework.
QC3	**Others involved in the audit**. The use of in-house specialists is described in paragraph 95 of the ITC. The ISA Post-implementation Review noted that regulators had reported that audit firms used different terminology to describe in-house experts and this was causing a problem with the consistent application of ISA 620. Audit teams use the same sorts of mechanism to control the work of both specialists and experts. One, relatively easy way to address this issue would be to turn the guidance in ISA 220 paragraph A20 into a requirement.
QC4	**The firm's role in supporting quality.** As discussed under questions PS3 and PS4 above more needs to be done in ISQC1 to emphasise the importance of partners and more senior staff providing less experienced staff with coaching / on the job training.
QC5	**Governance in the firm.** As suggested in the ITC I think it probably would be worthwhile to mandate a partner with specific responsibilities for ethics. This was done in the UK some years ago using Ethical Standards to require audit firms to appointment an 'ethics partner' and to describe the role such a partner needed to perform. However, in the early years it proved difficult for audit inspectors to know whether ethics partners were working as they should. This was largely due to a lack of documentation. If IAASB does decide to require firms to appoint an ethics partner it also needs to consider what documentation that person should be required to keep including probably a log of actions taken and advice given
QC6	**Engagement Quality Control Reviews.** As discussed above EQCRs could usefully focus on scepticism.
	It is some years since the ISA Post-implementation Review noted that regulators had difficulties in this area. There is a discussion in paragraph 144 of the ITC on whether a separate standard should be prepared. It seems to me that there is a very strong case for unbundling EQCRs from ISQC1 and therefore responding more quickly to the need for improved standards in this area.
QC8	**Engagement partner performance and reward systems.** I agree with the comments made in paragraph 167 of the ITC – this is a key area in the Audit Quality Framework.
QC9	**Human resources and engagement partner competency.** As described in the Audit Quality Framework one of the important attributes of audit quality at the engagement level is that partners and staff have the necessary competencies. The term competency is used in ISQC1 and the ISAs but it is hard to know what level of competency is required by the standards.
	This is a very difficult area as competencies are difficult to define and even harder to measure. Some useful work has been done by IAESB in its revision of IES 8 but it is not the complete answer to the problem, nor does IES8 fit into the regulatory regime as it does not apply to audit firms. Something more in this area is needed in ISQC1. The key must be for audit firms to define for themselves what competencies they need and to build systems to ensure they recruit, retain and reward individuals using that system. All firms have such systems but they vary greatly and place more or less emphasis on aspects of audit quality. Specifying some requirements in this area may be possible in ISQC1 and this could usefully be linked to the need for staff appraisals to deal with professional scepticism.

QC10	**Transparency reporting.** It is unclear to me whether anyone really uses the information provided in the transparency reports define by European law. I would not think that this is an important area of priority for IAASB.

Group audits

GA1	Personally I am surprised that people should be confused by what is meant by 'an audit of financial information of the component using component materiality'. This was quite clear to IAASB when it issued ISA 600 – it was an audit in accordance with the ISAs other than part of ISA 320 as materiality was prescribed by the group auditor. This could easily be clarified - I do not think that the old Board would agree with the possible action described in para 272 (b) (i) of the ITC!
GA 6	**Component materiality**. I agree the underlying problem is dealing with aggregation risk. This is a very difficult theoretical concept – rather like performance materiality in ISA 320. Some argue that component materiality needs to reflect the sampling approach adopted and, when IAASB developed ISA 600, one firm (that used Monetary Unit Sampling) strongly argued that component materiality should be the same as group materiality. I was pleased that the majority of the IAASB rejected this idea but we were unable to agree how much lower than group materiality component materiality should be. Some new thinking would it helpful as it seems likely to me that many firms are using much too high a level of component materiality.
GA 7	**Responding to identified risks.** The ITC suggests that some are challenging the value of the concept of significant components in identifying risk. However the role of significant components within ISA 600 is much greater than just for risk assessment purposes. As with all changes in makes the new IAASB needs to fully understand the thinking of old IAASB before making them. When IAAB finalised ISA 600 one of its main concerns was to make sure that sufficient audit evidence had been obtained – some thought that reviews (not audits) of component information would be enough. This issue was resolved by requiring all significant components to be audited (using the complete set of ISAs) to an appropriate level of materiality.