

Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York.10017  
USA

31 May 2019

Dear Mr Botha

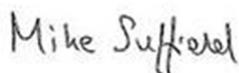
### **IAASB PROPOSED STRATEGY FOR 2020–2023 AND WORK PLAN FOR 2020–2021**

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the IAASB's consultation on its Proposed Strategy for 2020–2023 and Work Plan for 2020–2021 (SWP).

The consultation comes at a critical time for the IAASB. Audit plays an essential role in the economy, underpinning trust in capital markets and attracting investment. However, confidence in the audit has been adversely affected as a result of a high number of corporate failures and negative audit findings, leading to fundamental questions about relevance and trust. In the UK in particular, there is a call for fundamental change. In particular, the CMA<sup>1</sup> market study together with the Kingman<sup>2</sup> and Brydon<sup>3</sup> reviews are seeking to improve choice, the overall governance of the profession and the quality and effectiveness of audit respectively. Against this background it is timely for the IAASB to reflect on its objective to serve the public interest and take steps to strengthen public confidence in audit when implementing the SWP.

Our responses to each of the IAASB's consultation questions, including any further enhancements we propose, are set out in Appendix 1. We have also included some editorial suggestions in Appendix 2. If you have any questions about our response or wish to discuss any of our observations in more detail please contact Josephine Jackson, Technical Director on [j.jackson@frc.org.uk](mailto:j.jackson@frc.org.uk) or +44 207 492 2473.

Yours sincerely



**Mike Suffield**  
**Acting Executive Director of Audit and Actuarial Regulation**

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<sup>1</sup> The Competition and Markets Authority (CMA) launched a market study into the supply of statutory audit services in the United Kingdom in October 2018. It published an update paper in December 2018 made its final report on 18 April 2019.

<sup>2</sup> The independent Kingman Review of the FRC was set up to enhance the regulator's "transparency, independence and reputation and ensure that its structures, culture and processes, oversight, accountability, and powers, and its impact, resources, and capacity were fit for the future". The Review reported in December 2018. The UK Government is currently consulting on its recommendations.

<sup>3</sup> The Secretary of State for Business, Energy and Industrial Strategy in the UK invited Sir Donald Brydon (Brydon) to conduct a review into the quality and effectiveness of audit. The independent Brydon Review of the quality and effectiveness of audit was announced in December 2018. Brydon is expected to report on findings, following a consultation, late 2019.

### Responses to IAASB Consultation Questions

- 1) *Do you agree with Our Goal, Keys to Success and Stakeholder Value Proposition as well as the Environmental Drivers?*

#### *Goal*

We support the goal of the IAASB set out on page 6 of the consultation. However, the overriding objective for standard setting, and the primary consideration in determining priorities and allocating resources, must be to serve the public interest. Accordingly, we would expect the goal to encompass the IAASB's responsibility to serve the public interest. This could be articulated as follows: Sustained public trust in financial and other reporting, enhanced by high-quality audits, assurance and related services engagements, through robust global standards that are developed and maintained in the public interest and are capable of consistent and proper implementation.

#### *Environmental drivers*

We agree with the external environmental drivers set out on page 7 of the consultation. Collectively they highlight that the accountancy profession needs to adapt and change to an increasing pace of change in society, business and capital markets, rebuild trust, and advocate transparency and accountability. What appears to be absent from the consultation however is this wider context, that is, how the IAASB views the environmental drivers, not in isolation, but collectively in relation to the longer-term view of the audit profession and audit and assurance, and the role of the IAASB in this regard. We urge the IAASB, in finalising the SWP, to consider this as part of its research activities.

We also suggest, in finalising the SWP, that the IAASB clarifies the difference between changing reporting needs of stakeholders, shortcomings or failures in audit, and the 'expectations gap' so that the appropriate analysis can be undertaken, and an effective response achieved. The proposed SWP links changing shareholders' expectations to the topics of fraud, NOCLAR and going concern. These topics are not necessarily related to *changing* expectations, but instead related to shortcomings or failures in audit or a widening 'expectation gap' between what the public expects from an audit and what an audit is actually designed to do. In our view, changing expectations is more synonymous with changing reporting needs i.e. there is an increasing demand for assurance in areas other than traditional financial reporting in relation to historical and forward-looking information (financial and non-financial). Such assurance could result in an extension to the current scope of an audit or fall outside the scope of an audit.

Most organisations have internal and external environmental drivers. The internal environment is usually associated with the human resource of the organisation, the culture, technology and so forth, including the manner in which work is undertaken in accordance with the goal or objectives of the organisation. To some extent, the IAASB has addressed the internal environment by reference to the strategic actions in Theme D. However, in finalising the SWP, we believe the IAASB should explicitly recognise the internal environmental drivers. For example: lack of a timely response in certain circumstances has led to a degree of criticism from IAASB stakeholders; prioritising and responding to different and competing calls for action from varying stakeholders;

resource constraints due to the limited availability of appropriately skilled human capital (expertise and competence).

### *Stakeholders*

The IAASB's processes and work programme is influenced by the needs of varying stakeholders with different jurisdictional needs. Reconciling those needs, or prioritising different and competing calls for action, is challenging. In addressing those challenges, we suggest that the IAASB appropriately identify their stakeholders. Stakeholder identification is not only about determining who the stakeholders are but also about determining their specific needs and whether those needs are matters that should be addressed in the public interest. Stakeholder identification also assists the IAASB in identifying the best ways to manage their expectations.

### *2) Do you agree with Our Strategy and Focus and Our Strategic Actions for 2020–2023?*

Notwithstanding our response to Question 1, we are generally supportive of the strategic themes and actions articulated in the consultation, subject to the following suggestions:

#### *Theme D*

We support the IAASB further considering capacity and whether further resources are needed to deliver on the work plan briefly described in Theme D. However, there is no clear articulation of a vision for, or a proposed pathway to enhancing the IAASB processes in respect of Board time and Staff time. We have made this observation previously, including in our response letter to the Consultation on Proposed Strategy for 2015-2019 and Proposed Work Program for 2015-2016. In finalising the SWP, we strongly recommend that the IAASB identifies how more effective use can be made of current staff and Board members' time. We have offered some suggestions in Appendix 2.

#### *Theme B*

We are concerned that the description of the strategic actions in Theme B imply that the IAASB will pursue individual projects in relation to each of the standards, i.e. revise each standard, without first understanding the fundamental underlying issue(s) (i.e the environmental drivers).

Environmental drivers do not always have an immediately obvious or direct connection with individual standards, or standard-setting more generally, such as the 'decreasing or declining trust in audits as a result of corporate failures'. Such drivers are nonetheless critical matters to anticipate and research in order to establish whether they are matters that need to be addressed in the public interest, i.e. to justify further standard-setting activity or other IAASB led activity such as implementation activities. We therefore strongly encourage the IAASB to clarify in Theme B, that the strategic actions will include research to understand the fundamental underlying issue(s), before pursuing standard setting or implementation activity. In this regard, we suggest that Theme B is more appropriately cast as "Anticipate, Evaluate and Respond to Economic and Social Trends That Impact Our Profession".

In addition, as inferred in our opening remarks, the IAASB has a clear role to play in addressing the decreasing confidence and declining trust in audits arising from continuing high levels of poor inspection findings and high corporate failures in some jurisdictions, yet this environmental driver does not feature in the strategic actions. Also, as noted in our response to Question 1, the

difference between changing reporting needs of stakeholders and the expectations gap should be clarified.

We suggest that the IAASB consider the findings of the Brydon review in its research activities. The review is intended to take a fresh look at the scope of the audit, how far it can and should evolve to meet the needs of users of accounts, what other forms of assurance might need to be developed, and to define and manage any residual expectations gap. The review will also consider how audit should be developed to serve the public interest in future, taking account of changing business models, new technology and stronger public expectations.

In respect of Theme B and other Themes articulated in pages 8 to 13 we have made some recommendations in Appendix 2 that we believe would provide greater clarity regarding the relationship between the environmental drivers and the strategic themes and actions.

3) *Do you agree with the IAASB's proposed Framework for Activities, and the possible nature of such activities as set out in Appendix 2?*

We strongly support the IAASB's Framework for activities illustrated in the diagram on page 12 and detailed in Appendix 2 of the SWP. As proposed in our response to the Stakeholder Survey<sup>4</sup> in July 2018, we believe the Board should better balance the time spent on drafting standards with research and implementation activities. This approach is also consistent with the Monitoring Group's proposals that the Board should be more strategic. For such a revised model of operation to be successful, the IAASB is encouraged to develop much more effective collaboration and feedback mechanisms that enables it to work more successfully with its stakeholders, which has been briefly highlighted in Theme E.

*Research Phase*

We strongly support the introduction of a formal research phase (research programme) into the IAASB's framework for activities. As noted in our response to the Stakeholder Survey, thorough, balanced and evidence-based research is necessary for the development of high-quality standards that are based on clear principles and are in the public interest. Evidence gathering is essential to understanding the evolving environment and reconciling the needs of multiple stakeholders with different objectives and jurisdictional needs. A research programme arms the IAASB with a much greater understanding (i.e. evidence) of the needs, issues and challenges, and gives the IAASB a firm basis to assess a feasible solution.

The research programme should be where a significant amount of deep analysis is performed before any other activity, including standard setting, can begin and requires sufficient resource to be successful. In increasing capability and capacity to respond to research needs, the IAASB should look to enhancing collaboration with external stakeholders, such as National Standard Setters, professional bodies, academics, regulators and others (including other SSBs such as IESBA, PCAOB and the International Accounting Standards Board).

We support the recognition in Appendix 2 that following research on a topic, the IAASB may conclude that standard setting is not necessary or appropriate. Other more effective activities

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<sup>4</sup> Envisioning the Future—Survey on the IAASB's Future Strategy

may be appropriate to meet the needs of its stakeholders (e.g. educational activities, non-authoritative guidance, rapid response).

In finalising its proposals, we recommend the IAASB includes the research programme as part of its formal operating procedures, set out in its Terms of Reference. In addition, we recommend that the IAASB articulate, for example:

- what the strategy, objectives and processes of the research programme are;
- how the Board adds projects to its research programme (e.g. IAASB's goal and strategy, environmental drivers, post-implementation reviews) and sets priorities (e.g. using the IAASB's goal and strategy and other key guiding considerations);
- how the research programme interacts with related work in maintenance, standard setting, and implementation projects; and
- strategies for collaboration.

#### *Post-Implementation Reviews (PIRs)*

We support the recognition of PIRs in the research phase of the IAASB's framework for activities. PIRs have served as a useful tool, as the IAASB were made aware of implementation issues with a particular standard(s) and identified topics that should be investigated further.

We recognise that the mechanisms and processes for responding to issues identified through these reviews needs to be streamlined so that once a review is completed any urgent issues are addressed in a timely manner. However, as noted earlier, not all issues or topics identified will be urgent or result in standard setting, and some topics or issues may require further research to determine the right course of action. In addition, as noted in our response to the stakeholder survey, although PIRs are traditionally only performed for revised or new standards, the IAASB can conduct a PIR on any IAASB pronouncement when circumstances warrant this approach. In finalising its proposals, we recommend the IAASB take these factors into consideration when formalising this aspect of the research programme.

In addition, we recommend the IAASB formalises PIRs as part of the research programme in its operating procedures, set out in its Terms of Reference. In addition, we recommend that the IAASB articulate, for example:

- overall process in respect of PIRs (including timing);
- objectives of the PIRs (e.g. to evaluate if the pronouncement has achieved its original objective, does that objective remain appropriate, is the pronouncement still required/remains the best option for achieving that objective and could the objective be achieved in another way?); and
- in what circumstances would further research be required.

In addition, the level of analysis and resource required for a PIR will vary according to the particular facts relating to each situation. However, wherever practicable, if more significant

evaluation is required, we recommend that PIR should be built into a wider research programme where possible, so that all relevant evidence can be evaluated, and duplication of effort avoided.

#### *Implementation and Application of Standards (Implementation).*

We strongly support the introduction of a formal implementation programme into the IAASB's framework for activities. As noted in our response to the Stakeholder Survey a formal implementation programme is essential to adoption, consistent interpretation, application, and understanding of all the IAASB standards, including to effect behavioural changes to respond to the revisions in the standard and will therefore directly respond to the concerns raised by stakeholders that some standards are or will be challenging to apply in practice.

In finalising its proposals, we recommend that the IAASB considers:

- introducing a mechanism for ongoing support as part of the implementation programme, which will necessitate the development of a process for responding to questions about application of the IAASB standards.
- clarifying that the implementation programme offers transition support prior to the effective date. A formal pre-implementation programme will be reassuring to those stakeholders who perceive the standards to be unnecessarily complex. Pre-implementation support may also be attractive to those jurisdictions that have not embraced, or not fully embraced, the IAASB standards and to assist with interpretation or consistent application.

As with the research programme, we also recommend that the IAASB includes the implementation programme as part of its formal operating procedures, set out in its Terms of Reference, and allocates sufficient resource to the programme to ensure its success, including through collaboration with other stakeholders.

#### *Narrow-Scope Maintenance*

We strongly support the introduction of a maintenance programme, and recommend it is formalised as part of the IAASB's operating procedures. As indicated above, we support recognition in Appendix 2 of the SWP that following research on a topic, the IAASB may conclude that standard setting is not necessary or appropriate. Other more effective activities may include narrow-scope amendments.

However, before a narrow-scope amendment project is added to the work plan, the IAASB needs to establish that enough evidence has been gathered that clearly demonstrates that despite a legitimate application of requirements and use of professional judgement, there is significant widespread diversity in practice, and that there are no broader issues that need to be addressed before the matter can be resolved (or if so, such broader issues are also addressed). This will support the effectiveness of narrow-scope amendments in addressing the fundamental underlying issue(s) and avoid unintended consequences.

## Key guiding principles

We support the Key Guiding Considerations set out on page 14.

- 4) *Do you support the actions that have been identified in our detailed Work Plan for 2020–2021? If not, what other actions do you believe the IAASB should prioritise?*

We support the actions that have been identified in the work plan in respect of those strategic actions set out in Theme A, including the research activities in respect of audits of less complex entities and audit evidence. There are however a number of other topics that require the IAASB's attention, as discussed in our response to question 1 and question 2, (e.g. the collective impact of the environmental drivers on audit and assurance and the work of the IAASB, technology, the changing corporate reporting environment and so forth). We recognise that the IAASB is resource constrained, and it is not possible to address every topic, however in finalising the SWP, we recommend that the IAASB consider how they intend to approach the other topics, including through collaboration with others.

- 5) *Are there any other topics that should be considered by the IAASB when determining its 'information gathering and research activities' in accordance with the new Framework for Activities?*

Please refer to our response to Question 1 in respect of Strategic Themes where we urge the IAASB to understand the fundamental issues behind the environmental drivers before determining which standards need to be revised to address those issues.

In respect of information gathering and research activities, there are some specific FRC initiatives that we believe the IAASB should actively monitor in light of the potential of the initiatives to inform the IAASB's future agenda. In particular:

- **Going Concern** - The FRC issued a consultation on 4 March 2019<sup>5</sup> proposing changes to ISA (UK) 570 to increase the work which auditors are required to perform in relation to going concern. The consultation was issued in response to concerns about the quality and rigour of the audit of going concern given well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after, as well as findings from recent FRC Enforcement cases. The consultation period closes on Friday 14 June 2019.
- **Thematic Reviews** – the FRC inspection team carry out thematic reviews which make comparisons between audit firms with a view to identifying both good practice and areas of common weakness. In 2019 the FRC thematic reviews will consider the scope and content of audit firms' transparency reports and the use by audit firms of Audit Quality Indicators. Such reviews will offer insights into the ongoing development of ISQM1. The FRC also recently published the results from a thematic review relating to how auditors discharge their responsibilities in relation to the other information in the annual report<sup>6</sup>. We urge the IAASB to consider this review as it offers insights into the nature, extent and quality of the work performed by audit teams on the Other Information.

<sup>5</sup> <https://www.frc.org.uk/news/march-2019/frc-consults-on-stronger-going-concern-standard-fo>

<sup>6</sup> <https://www.frc.org.uk/getattachment/7afae1fe-75c8-43fc-9f60-3f2a78b438a9/AQR-Thematic-Review-Other-Information-in-the-Annual-Report-Dec-2018.pdf>



## FRC Editorials and Further Comments

### Strategic Themes

- Theme A – We are supportive of Theme A. It is important that the IAASB prioritises the completion of activities that were already in progress. In this respect, we would recommend that completion of the guidance for the EER project, is encapsulated in Theme A. (see Theme A below)
- Theme B – As discussed in our response to Question 2, the references in Theme B to individual standards implies that the IAASB will pursue individual projects in relation to each of the standards before understanding the root cause of the environmental driver. Environmental drivers do not always have an obvious or direct connection with individual standards, such as the decreasing or declining trust in audits as a result of corporate failures, or even standard setting in general. Such drivers are nonetheless critical matters to anticipate and research in order to establish whether they are matters that need to be addressed in the public interest, i.e. to justify further standard-setting activity or other IAASB led activity. The strategic actions articulated in the Themes do not necessarily capture this thought, and we therefore recommend that one of the Themes is articulated as such, for example: “Anticipate, Evaluate and Respond to Economic and Social Trends that Impact our Profession”. (See Theme B below)
- Theme C - Theme C articulates a strategy to develop ways to address complexity, while maintaining scalability and proportionality. We believe this matter is fundamental to *all* standard-setting activities, not just in respect of Audits of Less Complex Entities and therefore it would be more appropriate for the strategic actions in Theme C to fall more generally under “Further Challenge and Enhance the Fundamentals of Our International Standards”. We also propose that matters captured within this strategic theme have a more obvious or direct relationship with individual standards or standard setting more generally. (See Theme C below)

<b>Theme A</b>	<b>Complete Our Major Audit Quality Enhancements And Enable Them To ‘Take Root’</b> Strategic Actions – In the strategy period commencing in 2020, we will: <ul style="list-style-type: none"> <li>• Progress and complete, as a top priority, our projects on Quality Management and Group Audits. Develop implementation support for our projects on Quality Management and Group Audits, monitor the ongoing need and develop further support as necessary.</li> <li>• Continue implementation support for ISA 540 (Revised) and ISA 315 (Revised) and monitor the ongoing need.</li> <li>• Complete our Auditor Reporting and ISA 540 (Revised) Post-Implementation Reviews, report findings and determine and carry out necessary actions arising from these reviews.</li> <li>• Complete the guidance for our Extended External Reporting (EER) initiative</li> </ul>
<b>Theme B</b>	<b>Anticipate, Evaluate And Respond To Economic And Social Trends That Impact Our Profession</b> Strategic Actions – We will identify and prioritize future actions through our research activities related to: <ul style="list-style-type: none"> <li>• Decreasing confidence, and declining trust, in audits arising from continuing high levels of reported poor results of external inspections and recent high-profile corporate failures in some jurisdictions.</li> <li>• The expectations gap (including an analysis of whether there a gap between what is expected from auditors in relation to Fraud, NOCLAR, going concern, Other Information and what the standards require or are these shortcomings or failures in audit, or both)</li> <li>• The increasingly complex business environment( because of, for example, ongoing globalisation and advancing technologies).</li> <li>• Financial Reporting Standards – accounting standards are evolving and becoming more complex —as transactions become more complex and financial reporting changes.</li> <li>• Changing reporting needs of stakeholders.</li> </ul>

<b>Theme C</b>	<p><b>Further Challenge And Enhance The Fundamentals Of Our International Standards</b></p> <p>Strategic Actions</p> <p>Develop ways to address complexity, while maintaining scalability and proportionality:</p> <ul style="list-style-type: none"> <li>• As a top priority, complete our information-gathering and research activities relating to Audits of Less Complex Entities, which will inform the Board's future deliberations about the most appropriate actions to address the identified issues and challenges.</li> <li>• Commit to continue considering how to develop principle-based standards and guidance that is clearly articulated, and able to be applied to a wide variety of circumstances.</li> <li>• Enhance the accessibility and ease of use of our standards, for example by digitizing the standards to enhance navigation and search functions.</li> </ul> <p>The need for changes in the standards to address issues and challenges related to audit evidence, in particular in relation to evolving technologies and automated tools that are being used, as well as thinking more about how professional skepticism can be further enhanced within the ISAs.</p> <p>Further implications on our standards of evolving technologies used by entities and auditors.</p> <p>Ongoing work of the IESBA that may require changes within our standards.</p> <p>Continue our focus on professional skepticism in our ongoing ISA projects and consider what more can be done in this area.</p>
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## Effective use of Board and Staff Time

In respect of our response to question 2, Consideration could be given to the following matters:

- Task Forces typically involve a significant number of Board members and IAASB Technical Advisers who contribute significant amounts of their time on a volunteer basis. Reducing the size of task forces to no more than 4 or 5 individuals (which would include technical advisors accompanying members), enabling more task forces to be established.
- The limited number of Board meetings each year can also impose significant restrictions on how quickly projects are progressed. There has been some successful use of Board teleconferences, but it may be helpful to consider whether more meetings through video conferencing or other audio-visual means would be a further option to the call for greater agility, including supporting research and implementation activities, and finding ways to issue pronouncements in a timelier manner. For example, as the Board embraces its research programme, and seeks greater collaboration with external parties, it may be possible to deliver subject matter presentations through webcasts.
- Generally, it is desirable for staff members to follow an underlying project from initiation to conclusion. So, historically a staff member involved in standard setting through to consultation, is generally involved in the finalisation of the standard. However, given the activities of the IAASB are being significantly re-focused into research and implementation programmes, and staff resources are constrained, it may be appropriate to reassess whether this is the most effective model going forward.