PCAOB 2014 International Auditor Regulatory Institute

Washington DC - November 19, 2014

Summary of Comments by Guy Jubb, Global Head of Governance & Stewardship, Standard Life Investments Ltd

Jubb, who is a member of the PCAOB's Standing Advisory Group commenced by making the standard disclaimer that the views he expressed were personal and not those of the PCAOB.

He introduced Standard Life Investments as a major global investor with assets under management of US$420billion[1], which is headquartered in Edinburgh and has offices, in Asia, North America and Europe. He explained that his role is to engage with investee companies on a range of governance issues, including audit and risk, and hold their boards to account.

He went on to address three audit related issues, which he considered important needs for global investors.

1. INVESTORS NEED REALLY USEFUL AUDIT REPORTS

Jubb explained that most auditor reports don't get read. He pointed out that 'they're riddled with get out of jail free clauses' and tell investors nothing about the audit itself. However, he drew attention to the benefits of the enhanced auditor reporting that has been under way in the UK for well over a year and said that the enhanced audit reports had been really, really useful. Jubb explained that the information provided 'hooks', which had enabled much more effective engagement to take place between Standard Life Investments and its investee companies about audit related matters. He drew attention to the benefits of materiality being disclosed, though he noted that nearly all the disclosed materiality levels were pitched at around 5% of a relevant metric, such as net assets or profit before tax, and he expressed his surprise that there was not more diversity of materiality levels given the inherently different audit risk profiles of individual companies. Notwithstanding, he said that information contained in the enhanced auditor reports contributed to a feeling of increased investor confidence in the audit.

Referring to the scheduled release in January 2015 of revised auditor reporting standards by the International Auditing & Assurance Standards Board (IAASB), Jubb encouraged audit regulators to foster and champion innovation in audit reporting, noting the revised standards should be robustly enforced but treated as minimum standards of best practice. He emphasised that the audit firms should be encouraged by regulators, audit committees and investors to voluntarily disclose additional information about the audit, over and above the minimum requirements, in order to make the audit reports really, really useful for investors.

[1] As at September 30, 2014

2. INVESTORS NEED AUDIT FIRMS THAT ARE ROBUSTLY GOVERNED

Jubb pointed out that most global audit firms and networks fail the governance test. He highlighted that they have no independent non-executives, no independent checks and balances and no independent public interest challenge. This is a fundamental problem, he asserted.

He explained that since 2010 the UK has had an Audit Firm Governance Code, which is published by the Financial Reporting Council (FRC) and comprises 20 comply-or-explain principles focussing on:

- Leadership;

- Values;

- Independent Non-Executives;

- Operations;

- Reporting; and

- Dialogue.

Jubb, who represented investors on the Murray Group that developed recommendations for the FRC on which the Audit Firm Governance Code is based, drew attention to the diversity of approaches used by firms. For example, EY position their independent non-executives on their global council, whereas the majority of the other audit firms position their independent non-executives at the local UK level. He said that initially the audit firms were hesitant about implementing the Code, especially given the challenges in finding independent non-executives who satisfied the 'independence test' but they all now see the Code, in general, and independent non-executives, in particular, as beneficial. However, Jubb complained that the Audit Firm Governance Code was ‘a largely invisible Code', and that there was a low level of awareness of even its existence. This and other factors had contributed to a general failure by investors to engage audit firms about the Code and have a meaningful dialogue with them regarding their governance, as had been envisaged when the Code was launched. Hence, in Jubb's opinion, the state of affairs in the UK was still not good enough and, therefore, he was pleased that the FRC is currently undertaking a review of the Code.

Jubb concluded his comments on this issue by stating that he would like International Federation of Independent Audit Regulators (IFIAR) to set up a work stream tasked with developing a global approach to audit firm governance that will command the respect of investors and the wider public, as well as the audit firms and networks themselves - with compliance with that approach being an integral part of the licence to audit.

3. INVESTORS NEED MORE THAN FOUR

Referring to the problems associated with the dominance of the Big 4 global audit networks, Jubb said that they and their constituent firms are too big to fail, which has implications for audit quality, there are too few global firms and networks for global corporations to choose from when selecting an auditor, and regulators have taken too long ‘to grasp the nettle' of Big 4 dominance.

Alluding to the consequential implications of the dominance of the Big 4, Jubb said there is an accident waiting to happen but nobody, nobody, is doing anything about it. He emphasised that audit quality is perceived as potentially compromised, and capital market and financial stability are at risk. He pointed out that it this is a big issue for companies as well as investors.

Jubb referred to a lead editorial in The Guardian of October 24 2014, entitled 'Corporate auditing is too often a well-paid fiction under the control of a small cartel' [2], pointing out that this editorial

---

[2] http://www.theguardian.com/commentisfree/2014/oct/23/guardian-view-tesco-auditing-debacle-pwc-systemic-shambles

served to demonstrate that the dominance of the Big 4 is a public interest issue, as well as one for investors and companies. He went on to comment on regulatory efforts in the UK, Europe and elsewhere to promote greater choice by putting audits out to tender (but not in the US, which has rejected mandatory audit tendering). He said that the efforts were clearly failing to deliver the policy objective of greater auditor choice, noting that there is a natural bias to the Big 4 amongst most audit committee members - the 'you don't get fired for hiring IBM syndrome'.

Jubb said that this is a global problem that needs a global solution. Noting that he had waited patiently but in vain over many, many years for market forces to sort out the situation, Jubb cited the Financial Stability Board's (FSB) mandate under its Articles to address regulatory gaps that pose a risk to financial stability. He called on the FSB to collaborate with IFIAR or other appropriate global bodies with a view to developing recommendations for orderly change that will deliver a sustainable solution, mitigate the risks, and provide more auditor choice for global companies and investors.

Concluding his remarks on the Big 4, Jubb said that the silence of the lambs is deafening and that regulators will be judged ultimately by not only what they do but also on what they fail to do. Accordingly, he commended to them his call for action.

Guy R Jubb
November 2014