Audit Quality—Issues and IAASB Task Force Proposals

A. Background

Most Recent IAASB Discussions

1. At its December 2010 meeting, the IAASB considered the Task Force’s recommendation for the development of an international audit quality (AQ) framework.1

2. Comments from several IAASB members supported the view that such a framework would fulfill a number of valuable purposes, including that it would:
   
   (a) Establish a foundation for debate on AQ.
   (b) Help the IAASB in setting appropriate standards.
   (c) Facilitate dialogue with audit committees.
   (d) Help stakeholders make decisions about AQ and assist them in finding answers to questions such as how to assess AQ.
   (e) Provide useful input to the ISA Implementation Monitoring project.
   (f) Stimulate further research on AQ.

3. However, a number of IAASB members also thought that there was a need for greater specificity around the objectives and scope of the initiative, particularly in relation to how such a framework might be used.

4. A strong theme throughout the IAASB discussion was the need for a collaborative approach to the project. Dialogue and coordination with both key stakeholders and other parts of IFAC, including the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB), were flagged as important. Nonetheless, there was broad acceptance that the project should be one coordinated by the IAASB.

5. In addition, while there was agreement that there would be merit in building on the work of the UK Financial Reporting Council (FRC) on its AQ framework, there was a strong view that the approach to the IAASB project should be holistic rather than inwardly focused on the inputs to AQ.

Most Recent IAASB Consultative Advisory Group (CAG) Discussions

6. At the September 2010 IAASB CAG meeting, CAG Representatives generally expressed support for a substantive project. There was a suggestion that this project should have a broad scope, exploring the interactions amongst auditing, ethics and accounting education standards, as well as the key drivers of AQ. There was also some support for leveraging the work done by the UK FRC on the topic of AQ.

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1 The IAASB also considered and agreed to issue in January 2011 the thought piece Audit Quality: An IAASB Perspective. The thought piece can be accessed at: http://web.ifac.org/media/publications/3/audit-quality-an-iaasb-per/audit-quality-an-iaasb-per.pdf.
Comments from the IFAC Small and Medium Practices (SMP) Committee

7. In commenting on the project papers for the December 2010 IAASB meeting, the SMP Committee expressed general support for the proposal to develop an international AQ framework. However, the SMP Committee indicated that a particular focus should be given to the audit of small- and medium-sized entities (SMEs), questioning whether the AQ drivers for SME audits are necessarily the same as for larger audits. The SMP Committee also raised concerns about the cost of applying ISAs for SME audits and the complexity of financial reporting standards.

B. Matters for IAASB Consideration

OBJECTIVES AND SCOPE OF THE PROPOSED AQ FRAMEWORK

8. In its paper to the IAASB in December 2010, the Task Force stated that there is currently no clear international consensus on the forces that drive AQ. In particular, different stakeholders continue to hold different views on AQ, with some finding greater relevance in the factors underpinning technical quality and others focusing more on the relevance and adequacy of the outputs of the audit.

9. In the Task Force’s view, there is a strong case for developing on a collaborative basis an international AQ framework that describes the influences of input, output and context factors on AQ. Such a framework could serve a number of specific purposes in the public interest, namely:

(a) In relation to stakeholders generally

The framework could be used to facilitate closer working relationships and dialogue between the IAASB and key stakeholders as well as amongst the key stakeholders themselves, including investors, those charged with governance, regulatory and oversight bodies, and firms. In particular:

- Given the importance of building strong working relationships between the IAASB and various stakeholders (e.g., oversight bodies such as the International Forum of Independent Audit Regulators (IFIAR)), it would be helpful to have a framework in place as a basis for constructive discussions on AQ. Also, from the perspective of oversight bodies, a framework may be of assistance in harmonizing approaches to regulatory inspections around the world.

- A framework could be of high impact in helping to raise the level of awareness and understanding amongst stakeholders of the important elements of AQ.²

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² There is already active interest in a number of forums on the topic of AQ. For example:


particularly in developing countries or emerging economies, or in jurisdictions where there has been little or no debate on AQ.

- A framework would enable stakeholders to not only better understand how auditing standards fit into the AQ equation, but also recognize other elements of AQ that may deserve priority attention to enhance audit effectiveness. For example, a framework could prompt participants in the financial reporting process, such as regulators and other standard setters, to take further action to ensure that audits are performed to a consistently high quality. Additionally, a framework could be used to better inform those charged with governance about AQ and encourage them to think about the right questions to ask in the context of the audit.

(b) In relation to IFAC’s standard-setting Public Interest Activity Committees (PIACs)

- Given that standard setting is an evolving process, a framework could act as input to each of the standard-setting PIACs’ ongoing assessment of whether it has the appropriate set of standards. For example, it could facilitate IAASB consideration of whether there are areas within ISQC 1 and ISA 220 that may require attention. More generally, a framework could assist the IAASB, IESBA and IAESB in thinking through the implications of new standard-setting proposals.

(c) In relation to firms and professional bodies

- A framework could help firms when reflecting on how to enhance the consistent application of auditing standards or internally-developed guidance within the firms or across their networks. It could also help facilitate the communication of information about AQ by firms and professional bodies.

(d) In relation to academics

- A framework may help to stimulate relevant academic research on the topic.

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3 Some jurisdictions have already leveraged AQ frameworks to develop educational and guidance materials for those charged with governance. See, for example:

4 ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

5 ISA 220, Quality Control for an Audit of Financial Statements
10. The Task Force is firmly of the view that the key objective and output of the project are the establishment of the framework itself. What is needed in the public interest is a universal platform—hitherto absent—from which stakeholders can work to further examine AQ, discuss and share insights about it, and take appropriate actions to maintain and enhance it.

11. The Task Force therefore proposes that the objective of the project be articulated as follows:

To establish an international framework that describes AQ holistically including the influences of input, output and context factors. This framework will be used to illustrate:

(a) Stakeholders’ varying perspectives on AQ; and

(b) The important relationships between auditors and other key participants in the financial reporting supply chain (i.e., management, those charged with governance, investors and regulators), which influence AQ.

12. For consultation purposes, the inter-relationships between the ISAs and ISQC 1 and the elements of AQ will be described in order to elicit input as to whether there are areas for further enhancement within the IAASB’s standards. A preliminary outline of the proposed consultation paper is set out in the Appendix.

13. With regard to the SMP Committee comments, a number of the issues raised therein may be addressed by other projects. For example, the ISA Implementation Monitoring project is focusing on the application of ISAs for SME audits. That said, the Task Force acknowledges that liaison with the SMP Committee will be important to ascertain whether the input, output and context factors for SME audits are different from those for larger audits.

Matter for IAASB Consideration

Q1. Does the IAASB agree with the objective of the AQ project as articulated above?

PROPOSED PLAN FOR THE WAY FORWARD

14. Given IAASB agreement on the need for a collaborative approach to the project, the Task Force has identified on a preliminary basis the following stakeholders with whom to engage on this project:

- IAASB CAG
- IESBA
- IAESB
- SMP Committee
- IFIAR
- Investors
- International Organization of Securities Commissions (IOSCO)
- National auditing standard setters (NSS)
15. Subject to Board approval of the objective of the project, a possible timeline for discussion with these stakeholders is set out below, together with an indication of the timing for the various stages of development of the consultation paper. This timeline anticipates Board approval of the consultation paper in Q1 2012. Comments to be received in late 2012 on the consultation paper could then provide input to Phase 2 of the ISA Implementation Monitoring project.

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<th>Timing</th>
<th>Discussion/Outreach with Stakeholder Representatives</th>
<th>Activity</th>
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| April 28–29   | NSS                                                 | • Discuss thought piece  
• Confirm support for consultation phase, including objective |
| April/May     | • Forum of Firms  
• IFIAR Standards Coordination Working Group (SCWG)  
• IESBA and IAESB  
• INTOSAI  
• ICGN          | • Discuss thought piece  
• Confirm support for consultation phase, including objective |

**June IAASB Meeting**
- Update on discussions/outreach and other TF activities
- First discussion of consultation paper

| July          | IFIAR SCWG  
Investors                              | Discuss key aspects of draft consultation paper |

**September IAASB CAG Meeting**
- Discuss key aspects of draft consultation paper

**September IAASB Meeting**
- Status report to IAASB

| September     | IFIAR  
IESBA and IAESB  
SMP Committee | Discuss key aspects of draft consultation paper |

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6 This will include, as appropriate, consideration of Terms of Reference for the initiative.
Audit Quality—Issues and IAASB Task Force Proposals
IAASB Main Agenda (March 2011)

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<th>Timing</th>
<th>Discussion/Outreach with Stakeholder Representatives</th>
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<tr>
<td>October</td>
<td>• Forum of Firms • IOSCO</td>
<td>Discuss key aspects of draft consultation paper</td>
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December IAASB Meeting
- Update on discussions/outreach and other TF activities
- Second discussion of consultation paper

2012

March IAASB Meeting
- IAASB approval of consultation paper

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<tr>
<td>Publish consultation paper</td>
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<td>Discuss with NSS</td>
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Matters for IAASB Consideration

Q2. The IAASB is asked for its views on:

(a) The proposed list of stakeholders to be consulted, and whether there are other stakeholders that should be included; and

(b) The proposed timing for the various activities to be undertaken, including the indicative phases of the project.
Outline of Proposed Consultation Paper

1. Introduction
   - Background
     - Recap main ideas from AQ thought piece
     - Leverage schematic below to highlight:
       - Relevance of inter-dependencies between different elements of financial reporting supply chain to AQ
       - Stakeholder perspectives on AQ
     - Summary of recent IAASB discussions
     - Relevant external developments
Overview and purpose of consultation paper

- Objective—to develop an international AQ framework that will be of value to IAASB and stakeholders
- Builds on work done by UK FRC and others on AQ
- Rationale for an international AQ framework and how it can help achieve, maintain and enhance AQ

Guide for respondents

2. The financial reporting supply chain and audit quality

- Key participants in the supply chain
- Inter-dependencies between different elements of the supply chain from perspective of AQ

3. Input factors

- The culture within an audit firm
- The skills and personal qualities of audit partners and staff
- The quality of the audit process

4. Output factors

- The reliability and usefulness of audit reporting to users of audited financial statements
- The reliability and usefulness of audit reporting to management and those charged with governance

5. Relationship between ISAs/ISQC 1 and input/output factors

- Discussion of specific provisions in ISAs and ISQC 1 that address the input/output factors

6. Context factors

- National business practices, including the legal framework
- National culture
- The culture within the entity’s business
- The educational environment and resource capacity
- The applicable financial reporting framework (e.g. degree of complexity)
- The client’s reporting timetable
- The regulatory environment relating to auditors

7. Perceptions of audit quality and external expectations

- Perceptions of audit quality
- External expectations