

May 31, 2016

Prof. Arnold Schilder
Chairman
International Auditing and Assurance Standards Board
529 5th Avenue
New York, New York 10017

Re: Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control, and Group Audits

Dear Prof. Schilder,

CFA Institute¹ appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's ("IAASB" or "Board") Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control, and Group Audits*.

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

¹ With offices in Charlottesville, New York, Hong Kong, London, Mumbai and Beijing CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 125,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

Overview

Investors' perceptions regarding financial reporting effectiveness and consequently audit quality have been profoundly affected by how they experienced the events leading up to, during, and following the 2008 financial crisis. How well financial information served their needs during this tumultuous period unequivocally informs their views regarding the efficacy of financial reporting and the quality of audits.

As we state in our report [*Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust & Volume*](#),

Investors point to the countless reporting and analyses especially of high-profile financial institution failures and bailouts during, and since, the 2008 financial crisis as evidence of the insufficiency of disclosures in providing the necessary transparency to investors regarding exposures, risks, uncertainties, and leverage of such financial institutions.

This lack of transparency in financial reporting leads to loss of investor trust in both management and the audit process.

In light of this and the deficiencies noted by audit oversight bodies such as International Forum of Independent Audit Regulators (IFIAR) in recent years we believe there is a need for the IAASB to take steps to restore public trust and confidence.

Accordingly, we support the IAASB's proposal to address the public interest issues – professional skepticism, quality control, and group audits – as outlined in Table 1 of the Overview. We are also supportive of the notion of keeping abreast of emerging issues (e.g. technology, increasing business complexity) to ensure that the International Standards on Auditing (ISAs) remain relevant as these are important steps towards restoring public trust.

Professional Skepticism

We believe it is important to re-emphasize the important role of professional skepticism in all aspects of the audit from planning to risk assessment, to scoping, to execution including challenging management assertions.

To achieve proper application of professional skepticism the IAASB should develop a professional judgment framework to establish a process whereby an auditor can apply professional skepticism and arrive at a conclusion. This would involve:

- Defining the issue
- Identifying alternatives
- Collecting evidence
- Reaching and documenting the conclusion.

Further we believe the IAASB should:

- explore the different definitions of professional skepticism to ascertain whether the ISA definition is most appropriate;
- clarify the application of professional skepticism in an audit;

- emphasize the role that firms play in developing a skeptical mindset;
- explore behavioral and training issues; and
- consider emphasizing the importance of professional skepticism when revising specific ISAs;

to ensure appropriate application of professional skepticism in order to raise audit quality.

We draw your attention to the recent survey conducted by CFA Institute as it relates to behavioral biases in investment decision making, which identified that professional skepticism was most useful for successful investment decision making. Professional skepticism we believe is applicable in making decisions about investments as well as audits. From the survey, respondents overwhelmingly The survey and further analysis can be found via the following CFA Institute blog: [*The Behavioral Continuum: What's the Best Behavioral Bias?*](#)

We understand that this behavioral aspect as it relates to the auditor is complicated and that the IAASB will be challenged to further strengthen the audit standards and related application guidance. None the less it is a foundational concept in advancing further changes in auditors delivering high quality audits.

CFA Institute agrees that the IAASB's efforts in the areas of quality control, group audits and accounting estimates provide opportunities to reinforce the concept of professional skepticism.

Quality Control

In the wake of the financial crisis and the suggestions received from regulators and oversight bodies on the need to improve quality control standards, we support the IAASB undertaking a comprehensive review of the standards that address quality control at both the firm and engagement level (i.e. International Standard On Quality Control (ISQC) 1 *Quality Control for Firms That Perform Audits and Reviews Of Financial Statements, and Other Assurance and Related Services Engagements* and ISA 220 *Quality Control for an Audit Of Financial Statements*). A high-quality audit of the financial statements is an integral element to the effective functioning of the global capital markets. To that end, an audit firm's governance plays a critical role to ensure that there is an appropriate balance in how a firm conducts its responsibilities for leadership, ethics, engagement performance and human resources. At the foundation for delivering a high-quality audit, is the firm's integrity, skepticism and independence from clients.

We offer the following additional comments on select sections of the Overview:

Quality Management Approach

We support the IAASB's proposal to develop a quality management approach that would be incorporated in ISQC 1. Further we agree with the objective of the QMA as set out in paragraph 53 of the Overview:

A QMA would integrate a firm's policies and procedures within its quality system through identification of relevant risks to quality and design of appropriate policies and procedures to address those risks.

We also agree with the key elements of the QMA as identified in paragraph 65 of the Overview. We believe it is important that the QMA stress that firm leadership is responsible for establishing

the firm's overall culture as culture plays an important in ensuring that partners and staff act in the public interest.

Firm Level: Monitoring and Remediation

Audit inspections by the international regulators as organized under the International Forum of Independent Audit Regulators (IFIAR) provide a key oversight role in audit quality. To that end, we agree that the IAASB should strengthen ISQC 1 to include policies and procedures to emphasize the need for, and importance of, actions firms take to respond to inspection findings.

IFIAR released its [2015 annual inspection findings](#) earlier this month revealing that 43% of inspected audits of listed public interest entities had at least one inspection finding. This compares to 47% in the previous year. Announcing the survey findings, IFIAR Chair Janine van Diggelen said:

“While this is a four percentage point drop in deficient audits over last year, IFIAR is not yet satisfied that enough has been done by the audit profession to understand and address shortfalls in audit quality. The outcomes continue to show a lack of consistency in the execution of high-quality audits and highlight concerns over the robustness of the firms’ internal quality management systems.”

It is clear that audit firms in general are not doing enough to address the deficiencies in the audits, and therefore ISQC 1 should embed a requirement for these deficiencies to be considered and changes made to improve root cause problems.

We also, firmly agree with the notion that audit quality is driven by “tone at the top” and this behavioral aspect should be strengthened in the standard. Also, we think that the IAASB should go a step further and include the importance of “tone at the middle” which has been suggested in public conversation as a means to embed ground level action in conducting the audit. In other words, it is audit firm staffing below the senior firm leadership who has most significant impact on audit quality at the engagement level. This would have the effect of driving the “tone” into the ranks of audit firm personnel.

Firm Level: Quality Control Policies and Procedures When Operating as Part of a Network

CFA Institute believes the IAASB should seek to develop requirements for networks, notwithstanding the expressed difficulty of the IAASB developing requirements for networks due to differences in firm structures and the requisite laws and regulations these different jurisdictions may need to abide by.

Investors and others do not differentiate an audit by firm network and other firm legal structures when relying on an audit. They simply see it as one audit no matter the structure of the engagement of other firms to get the job done.

Transparency Reporting

CFA Institute strongly urge the IAASB to further seek ways in which audit firm transparency reports contribute to audit quality. We agree with the following statement by IOSCO in their November 2015 report:

Transparency reporting can foster internal introspection and discipline within audit firms and may encourage audit firms to sharpen their focus on audit quality, which would be of benefit to investors and other stakeholders. In comparing audit firms competing for an audit engagement, audit firm transparency reporting can aid those responsible for selecting a public company's auditor in their decision making process by providing information on a firm's audit quality.

From IOSCO's report we believe that the following should be firmly rooted in the reports:

- clear, useful and presented in sufficient detail to be meaningful to the different groups of likely users of the report
- fact-based and not potentially misleading
- unbiased and not oriented toward marketing or selling services
- concise, specific to the firm and avoids the use of boilerplate language
- timely, accurate and complete
- balanced in communicating the audit firm's output measures of audit quality in addition to any input measures
- sufficient in terms of explaining the limitations of the indicators of audit quality, including that the indicators may not be comparable across audit firms

These transparency reports should enhance audit quality and provide investors with useful information provided they are objectively prepared in a transparent and non-boiler plate manner. Further, these reports should not dilute the usefulness of them by containing an overabundance of marketing information and be written in a plain English manner to enhance understanding by the reader.

Engagement Level; Engagement Partner Roles and Responsibilities

We agree that the IAASB should pursue a holistic review of the engagement partner's sole and responsibilities. This review should rightly address how these responsibilities transcend corporate structures and multi-location audits. Further we agree that users could better understand these responsibilities and how they are affected by firm and corporate structures.

Firm and Engagement Level: Engagement Quality Control Reviews and Engagement Quality Control Reviewers

Given the complexity of many audit engagements, we believe that the engagement quality control review (EQC) is an integral component of ensuring audit quality and as such a detailed review of the EQC responsibility is critical. We draw your attention to the importance of the EQC review given the December 6, 2013 issuance of the PCAOB report: [Observations Related to the Implementation of the Auditing Standard on Engagement Quality Review](#) which highlighted significant audit deficiencies which should have been identified by the engagement quality control review partner.

Group Audits

Given the complexity of group audits involving component auditors, network firms, different jurisdictions etc., the questions that have arisen from stakeholders regarding the application of ISA 600 *Special Considerations—Audits Of Group Financial Statements (Including the Work Of Component Auditors)* and the concerns raised by regulators and audit oversight bodies regarding group audits we believe the IAASB needs to undertake a project to review ISA 600 and how it relates to the other standards, in particular ISA 220.

This is essential in order to manage audit risk and raise the quality of the audit. We agree with the specific issues identified in paragraphs 96 and 97 of the Overview that need to be addressed in revising ISA 600. Furthermore, we believe the standard should reinforce the concept of professional skepticism.

Conclusion

CFA supports the direction and approach of the IAASB towards enhancing audit quality in order to restore public trust and confidence. We encourage the IAASB in continuing to conduct outreach with all stakeholders through roundtables and other means. CFA Institute would be happy to be involved in such outreach efforts.

Thank you again for the opportunity to comment. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org, or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/Sandra J. Peters

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