



June 24, 2016

Prof Arnold Schilder
Chairman
International Auditing and Assurance Standards
Board
529 Fifth Avenue
New York
10017 USA

Subject: COMMENTS ON THE IAASB INVITATION TO COMMENT: *ENHANCING AUDIT QUALITY IN THE PUBLIC INTEREST*

Dear Prof Schilder,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) Invitation to Comment, Enhancing Audit Quality in the Public Interest. As an international organisation of independent audit oversight regulators that share the goal of serving the public interest and enhancing investor protection, IFIAR is committed to improving audit quality globally through the promotion of high-quality auditing and professional standards, as well as other pronouncements and statements.
2. The IFIAR's objectives are as follows:
 - Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.
 - Promoting collaboration and consistency in regulatory activity.
 - Initiating and leading dialogue with other policy-makers and organisations that have an interest in audit quality.
 - Forming common and consistent views or positions on matters of importance to its members, while taking into account the legal mandates and missions of individual members.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of the IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisations.

4. Where we did not comment on certain specific matters, this should not be interpreted as either approval or disapproval by the IFIAR.

General comments

Focus on public interest

5. As audit regulators, we believe that consideration of the public interest, including the needs of investors and other users, should drive the projects to enhance auditing standards. We note that the IAASB has placed specific emphasis in the ITC on identifying relevant issues to be addressed by the projects, in the public interest. We encourage the IAASB to continue to maintain its focus on the public interest as it proceeds in its consideration of the issues identified as relevant in the ITC and the development of the revised standards.

Scope of ITC project

6. We note that a number of areas of concern which were raised by members of IFIAR with the IAASB have been included for consideration in the consultation paper. We encourage the IAASB to investigate further the possible solutions currently set out in the ITC, to ensure that the revised standards lead to improvements in audit quality, in a timely manner. We would, however, like to draw the IAASB's attention to our detailed comments regarding some of the possible solutions, which are set out in the individual topic sections of this letter.
7. We do not, in this letter, provide final views on the possible changes envisaged since the drafting of the text of those changes in the standards is not available at this stage of the consultation.

Over-emphasis on the development of guidance and application material

8. Many of the possible solutions set out in the ITC appear to focus primarily on the development of additional guidance and application material in the standards, as opposed to enhancing the requirements included in the standards. We believe that this is likely to have a limited impact on auditor behaviour in practice. Accordingly, we encourage the IAASB, as it progresses in its work, to direct its focus at enhancing the relevant requirements. Concomitantly, we believe that the IAASB should assess whether issues can be addressed by improving or clarifying current requirements rather than creating new application material to be included in the standards.

Professional scepticism

9. We support the IAASB's commitment to address the topic of professional scepticism in order to find actions that the IAASB and others could take to enhance the application of professional scepticism since this issue is indeed linked with audit regulators' findings (as mentioned in the [2014 IFIAR Inspection Findings Survey Report](#) and [2015 IFIAR Inspection Findings Survey Report](#)).
10. The ITC states that the IAASB's current efforts on quality control and group audits provide opportunities to reinforce the concept of professional scepticism [ITC §38]. In our view, the ITC does not allow for a clear view of the direction the IAASB wishes to take regarding professional scepticism in relation to quality control (ISQC 1 and ISA 220) and group audit (ISA 600). Please refer

to our specific comments on professional scepticism in the Group Audit and Quality Control sections of this letter.

Improvement of professional scepticism driven by enhancements in the IAASB standards

11. We believe that auditor's behaviour would be enhanced by ensuring that requirements sufficiently reflect the application of professional scepticism throughout the audit process in conjunction with further exploring behavioural aspects, training, clearer language in the standards and other issues. Although not a complete list, we believe that the IAASB should ensure that the following standards sufficiently promote the application of professional scepticism:

- ISA 315, ISA 330 ISA 500 and ISA 520 – when performing risk assessment procedures, in designing and implementing appropriate responses to those risks as well as when performing audit procedures (including substantive analytical procedures and analytical procedures near the end of the audit).
- ISA 320 and ISA 450 – when applying the concept of materiality in both planning and performing the audit, and in evaluating the effect of identified misstatements (including any uncorrected misstatements).
- ISA 620 – when using the work of an expert.

Additionally, the ITC sets out how the IAASB will stress the importance of professional scepticism as part of its work to revise ISA 540 [ITC §39]. Accounting estimates generally involve a high level of management judgment and therefore there is an increased risk of unintentional or intentional management bias. We support the IAASB in investigating further how ISA 540 can be strengthened to improve the focus on auditors approaching accounting estimates with a more questioning mind-set and in highlighting the need to consider the effect of contradictory audit evidence that comes to the auditor's attention, rather than an approach overly focused on corroboration.

We encourage the IAASB to consider whether other standards might require comparable attention.

12. We also encourage the IAASB to identify further factors that can encourage the application of professional scepticism as well as those that inhibit the application of professional scepticism. In particular we believe that the effect on the application of professional scepticism of cost and profit pressures, client relationship pressures, deadline and workload pressures and resourcing pressures within the firms, deserve further consideration.

Timing of the projects

13. We welcome the IAASB's initiative to address the topics of professional scepticism, quality control and group audit as a whole. However, we note that the ITC indicates that the way forward for the professional scepticism project will significantly lag behind the way forward for the projects on quality control and group audits. We draw the IAASB's attention to the need to remain committed to an integrated approach in addressing professional scepticism within other current

projects. The difference in timelines should not result in differing enhancements of consideration of professional scepticism in ISQC 1, ISA 220 and ISA 600.

Quality control

Tone at the top of the firm, including leadership responsibilities for quality

14. Senior management within the firm taking responsibility for audit quality is critical for setting an appropriate tone at the top and culture within the firm. In order to achieve this, the IAASB should consider defining clear responsibilities regarding firms' leadership being 'in control' of audit quality, including promoting a culture which supports appropriate professional scepticism, and related firm governance matters.

New quality management approach

15. We note that the ITC describes a significant change from the current approach to a quality management approach. Although we do not have any specific objections to the quality management approach, there is limited information at this stage for us to fully assess its merits.
16. For purposes of further developing this approach, we have provided some examples where further clarity is required:
 - a. The linkage between firm governance and the quality management approach needs to be clear.
 - b. If a quality management approach is adopted, the IAASB needs to consider the implications for other auditing standards, for example ISA 220 and ISA 600 to ensure consistency in managing audit quality at an engagement level and in a group audit context respectively.
 - c. It is unclear how the IAASB would successfully blend the current and strengthened requirements into a revised risk based approach to quality control, which is scalable, in order to provide sufficient direction for firms to implement an effective system.
 - d. If a quality management approach is adopted, the IAASB will need to establish provisions for setting quality objectives and identifying quality risks, since any error or omission at the risk assessment stage could lead to significant risks at the audit firm level that are not properly addressed.

Quality control at an engagement level

17. In order to improve audit quality at engagement level, we believe that establishing a framework for the audit engagement partners to determine the appropriate level of their involvement in the respective engagements would be necessary.
18. In ISA 220, such an approach would have the potential to drive change (for example, by requiring more audit engagement partner involvement in higher risk areas of the audit or when circumstances lead to an elevated level of audit quality risk). Establishing limitations on what can be delegated by the audit engagement partner could also be considered (for example, review of audit work relating to significant risks).

19. In ISA 600 this type of approach would aid the group audit engagement partner to determine the appropriate level of involvement in respect of the work performed by component auditors. Further comments addressing the use of audit work performed by component auditors are included in the Group Audit/ISA 600 section of this letter.

Quality control policies and procedures operating through a network

20. We recognise the importance of considering quality control policies and procedures operating through a network. However, we would caution how the IAASB considers such an approach and the impact that approach may have on audit quality. Any proposed revisions would need to ensure that, before relying on any network procedures, the local firm has sufficient evidence about the effectiveness of the global network controls, for example consideration of the nature, extent and results of global monitoring arrangements over global controls, the local firm's determination of which global controls are appropriate in the local environment and include an overarching requirement that the local firm issuing the audit report will need to obtain the necessary information relating to the competence and performance of other network personnel participating in the audit. There may also be operational issues such as restricted access in certain jurisdictions as well as consideration of the completeness of information obtainable by the local firms from the global network.

Engagement Quality Control Reviews ('EQCRs')

21. We note that the ITC does not clearly address the objective of engagement quality control reviews, although the issue has been recognised. We believe that a clearly defined objective needs to be articulated for the EQCR in order to drive improved behaviour by engagement quality control reviewers and audit firms in performing reviews and establishing policies and procedures for EQCR respectively.
22. We encourage the IAASB to clarify and highlight throughout the standards, the fundamental principle of professional scepticism in the performance of an EQCR. This can be reflected in changes that require the engagement quality control reviewer to review and challenge the audit work performed in respect of the judgemental and higher risk areas, thereby clearly addressing the significant decisions made by the engagement partner.
23. There is a lack of granularity in the ITC on the criteria for selecting engagement quality control reviewers. The criteria for selection should consider the results of audit quality assessments, both external and internal, and links with the relevant ethical provisions in respect of long association with an audit client.

Monitoring

24. The discussion in the ITC relating to monitoring focuses on root cause analysis and the consideration of external inspection findings. We believe it is also important that issues relating to firm's internal monitoring are addressed. In particular, the IAASB needs to review the requirements relating to internal monitoring reviews of individual audit engagements in order to avoid 'compliance' focus, or a so called "tick-box approach" and to promote an approach focussed on substantive reviews of the quality of work performed on higher risk and judgemental

areas, with appropriate time and resources allocated for this. Firms' approaches to internal monitoring should allow for comparison to external inspections performed by regulators.

25. Further, internal monitoring reviews of 'firm wide' controls need to be given greater weight and their effectiveness assessed in light of findings from internal monitoring of individual audit engagements. If a quality management approach is adopted, it is essential that the audit firm can demonstrate that its internal controls over audit quality are effective.
26. Regarding root cause analysis, we support appropriate requirements for audit firms to perform root cause analysis on weaknesses identified through internal and external inspections, in particular regarding the factors to take into account when performing root cause analysis. In addition to assessing audit deficiencies, root cause analysis should also be performed to identify the attributes of high-quality audit engagements to promote quality across the audit practice.¹

Audit Delivery Models ('ADMs')

27. We note that the ITC describes the use by the auditor of outsourcing and shared service centres (collectively referred to as ADMs in the ITC). We believe it is important that coordination between the engagement team and the ADM teams are addressed by the IAASB for example, to reflect the varying circumstances associated with the nature of the services provided by ADMs.
28. Further we believe that the level of judgement involved, the complexity of the work and materiality of the balances should be included as some of the key factors in establishing whether it is appropriate to "outsource" work and the level of involvement required by the engagement partner in respect of the outsourced work. Consideration should be given as to how these responsibilities integrate with those in ISA 220.
29. We encourage the IAASB to ensure that the quality control arrangements at an ADM incorporate relevant specific subject matter areas, for example independence, training, HR matters and internal monitoring of audit work performed by ADMs.

Human Resources

30. Firms' compensation policies need to be consistent with the overriding objective of promoting audit quality. We therefore believe that the IAASB should seek to develop requirements which positively influence the extent to which those policies take account of audit quality.

Transparency reporting

31. Transparency reporting by firms can contribute to improving audit quality by facilitating external scrutiny of a firm's quality control arrangements and enhancing their accountability to external stakeholders. We therefore support the IAASB considering further whether ISQC 1 has a role to play in this developing area, having regard to experience in those jurisdictions where such reporting is already required.

¹ Refer to IFIAR Report on 2015 Survey of Inspection Findings, page 4/5

Group audit

Interaction between ISA 600 and other ISAs

32. We believe that the revised ISA 600 should make clear that its application does not supersede the need for the auditor to comply with all other ISAs. The ITC considers the interaction between ISA 600 and other ISAs, including ISA 220 [ITC §191-203], and places particular focus on certain areas of the audit where, according to the IAASB, the link to other standards is of most importance [ITC §198]. We agree that those are important areas to be highlighted in the context of a group audit but we caution against these areas being highlighted to the detriment of other areas of the audit and the related ISAs. We invite the IAASB to maintain the focus on the applicability of all relevant ISAs in a group audit context.

Involvement of the engagement partner

33. We encourage the IAASB to clarify and highlight throughout the standards, the fundamental need for direction, supervision and review by the engagement partner of the work of others involved in the audit - whether they be members of the audit engagement team, specialists or other external auditors - at all stages of the audit. We note, in particular, that the ITC addresses the issue of the involvement of others in the audit in the section on quality control [ITC §87-104]. We believe that consideration of this issue should be extended to group audits and the use of the work of component auditors.
34. In addition, the IAASB should ensure that its proposed actions appropriately address cases where the engagement partner is in a different location from where the majority of audit work is performed, such as audits of so-called "letter-box companies".

Materiality

35. We believe that the application of the concept of materiality specifically in a group audit context requires clarification [ITC §260–261]. In particular, the notion of "aggregation risk" in relation to the required work effort, establishing component materiality, as well as identifying significant components, would benefit from more clarity in ISA 600 to ensure that the standard can be consistently applied.
36. Furthermore, while we understand the need for compatibility between the accounting standards and auditing standards regarding the concept of materiality, we do not believe that action from the IAASB in this regard should depend solely on the progress of the International Accounting Standards Board's project on the same issue [ITC §260]. We encourage the IAASB to move forward timeously in addressing materiality in a group audit context, in particular component materiality and "aggregation risk".

Risk assessment and responses to risks

37. We agree that risks identified at component level should be taken into account at group level [ITC §253(b)]. However, this should be an explicit requirement as opposed to application material in the standard. Moreover, we would like to draw the IAASB's attention to the additional need for the

group engagement team to further ensure that appropriate procedures to cover the risks identified at component level are effectively implemented by the group engagement team or the component auditor.

Group engagement team involvement in the component auditor's work

38. We encourage the IAASB to develop a robust framework for determining the scope of work with respect to components and extent of involvement of the group auditor in the work performed by others, in particular component auditors. The possible actions set out in the ITC regarding the auditor's response to identified risks of material misstatement, and more specifically the audit procedures performed on the component's financial information, include a proposed revision to the approach to work to be performed on the component's financial information for group audit purposes and a suggestion to move towards a more flexible approach [ITC §272-273 and 279]. We would like to draw the IAASB's attention to the fact that a flexible approach that is not well defined could be unclear to auditors and may result in an inappropriately determined scope of audit procedures to be performed at component level. We invite the IAASB to consider the broader implications and unintended consequences that a more flexible approach might have.
39. We believe the IAASB should provide additional clarity on the work effort required by the group auditor in evaluating the work performed by component auditors. In particular, we believe the group auditor should determine the necessary extent of review of the work performed by and the related working papers of component auditors and whether the necessary access to component auditors' working papers will be available.

Communication between the group engagement team and the component auditor

40. We believe there is a need for improvement in the quality and timing of communications between the group engagement team and the component auditor generally. We encourage the IAASB to maintain the focus on improved communication between group and component auditors throughout the audit. The possible actions proposed in the ITC relating to communication between the group engagement team and the component auditor address specifically the ability of the group engagement team to communicate directly with the component auditor or component management when the group engagement team is aware of non-compliance or suspected non-compliance with laws and regulations (NOCLAR) that may be relevant to the work of the component auditor [ITC §224(e)]. We support improved communication of NOCLAR matters and believe it is also important to improve communications in relation to other areas of the group audit.

Specific documentation requirements

41. The ITC refers to the possibility of increasing the documentation requirements in certain areas of the group audit [for example ITC §303]. We see a benefit in emphasizing the importance of audit documentation on critical audit areas either in ISA 600 or in ISA 230.

IAASB future work plan 2017-2018

42. In reference to question G2 of the ITC, we refer the IAASB to [IFIAR's 2015 Survey of Inspection Findings](#)² in which those international standards that address the topics and audit procedures related to the areas with the greatest level and frequency of observed inspection findings have been identified.

Should you wish to discuss any of our comments, please do not hesitate to contact me or Marjolein Doblado, Chair of the IFIAR Standards Coordination Working Group.

Yours Faithfully,

A handwritten signature in black ink, appearing to read 'J. van Diggelen', with a long horizontal flourish extending to the right.

Janine van Diggelen
IFIAR Chair

² Please refer to pages 24 – 25 “*Consideration of Standard Setting*” and B-1 to B-2 “*Appendix B: IAASB Standards Related to Areas of Inspection Findings*”