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Submitted electronically to jamesgunn@ifac.org

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Dear James

Comments on the Consultation Paper: A Framework for Audit Quality

The Independent Regulatory Board for Auditors (IRBA) is the Audit Regulator and National Auditing Standard Setter in South Africa. The IRBA has as one of its statutory objectives the protection of the public by regulating audits performed by registered auditors, and the promotion of investment and employment in the Republic.

We appreciate this opportunity to comment on the Consultation Paper: *A Framework for Audit Quality* developed by the International Auditing and Assurance Standards Board (IAASB).

Our comments have been prepared by a Task Group of the Committee for Auditing Standards (CFAS), the committee responsible for standard setting in South Africa comprising representatives from SMP, large firms and the public sector. Our comments are presented in the following sections:

1. General comments; and
2. Request for specific comments and responses.

Kindly e-mail me at svanesch@irba.co.za, or phone on direct line: +27 87 940 8871 if further clarity is required on any of our comments.

Yours faithfully



Sandy van Esch
Director: Standards

1. GENERAL COMMENTS

We support the IAASB's efforts in developing the *Framework for Audit Quality (FW)*. We believe that the development of a FW, that describes the key drivers of audit quality, contributes to a broader understanding by different stakeholders of the complexity and multiplicity of factors that impact the quality of an audit. We also support the IAASB's view that the development of such a FW is in the public interest for the reasons stated in the "Foreword from the IAASB Chairman".

We have the following general observations that are articulated more fully in our responses to the specific questions.

Authority of the Framework

- a) We are not clear regarding the intended status and authority of the FW in relation to the IAASB's International Engagement Standards, in particular, the relationship between the FW and the IAASB's 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* is unclear. Auditors are generally required to comply with the Auditing Standards and or Audit Regulations prescribed in their respective jurisdictions, and their applicable Code of Ethics, in the conduct of an audit.

Objective of the Framework

- b) Although the IAASB has articulated their vision for the objectives of the Framework (FW), the purpose and anticipated use of the FW is not clear. For example, it is unclear whether the input and output factors and interactions included in the FW are intended to provide:
 - educational guidance; or
 - criteria, to assist auditors with implementation to enhance audit quality; or
 - criteria that might be useful when evaluating of the quality of audit services provided, by:
 - an auditor,
 - an audit regulator;
 - audit committees, management and those charged with governance (this latter may require the development of further tools to assist non-auditors in evaluating the quality of audit services provided.
- c) The possible impact on audit quality of interactions between an auditor, management and those charged with governance, who might seek to place undue time constraints and fee pressures on the auditor, while failing to provide requisite information appropriately prepared timeously for audit that might negatively affect audit quality, does not appear to be considered. The FW could discuss factors that auditors might consider and apply in such circumstances to ensure audit quality is none-the-less achieved.

Challenges in defining audit quality

- d) We acknowledge the difficulty in establishing a uniform or singular definition of audit quality which is understood and accepted by all stakeholders, as the interpretation of audit quality may differ between each stakeholder. We believe that there currently exists a shared desire by all stakeholders for continual improvement to audit quality, but do not believe that a pure "*definition of audit quality*" can be achieved.
- e) However, we believe the FW goes a long way to identify and articulate the various factors underpinning audit quality, so that the inter-relationships between them can be better understood by auditors and other stakeholders.

2. REQUEST FOR SPECIFIC COMMENTS AND RESPONSES

Question 1

Does the Framework cover all of the areas of audit quality that you would expect? If not, what else should be included?

Response:

Important factors that affect audit quality, not currently incorporated into the Framework

- a) *Use of Information Technology:* Although item 1.7.2 discusses the use of information technology, a critical aspect of enhancing audit quality is the need to remain up to date and responsive to changes in the environment – for example use of data analytic techniques has become necessary for many audit engagements. Such a responsibility would be at an engagement and a firm level, since it is important that firms provide the tools and training to practitioners to support them with the use of innovative audit techniques.
- b) *Public sector audit considerations:* the FW does not include factors relating to the quality of *performance audits* and the quality of *investigations and information systems audits* which in turn may enhance the quality of regulatory audits in the public sector.
- c) *Regulatory reporting requirements:* Consideration by the *industry regulators* regarding tight time frames set for audited financial statements to be submitted by regulated entities, may result in the audit process being rushed and audit quality being compromised.
- d) *Audit committee effectiveness:*
 - If the audit committee comprises one or more "unqualified" non-executive directors they may experience difficulty determining whether, for example, the audit fee is fair, whether the auditors are independent, and how best to evaluate the quality of the audit services provided, etc.
 - The qualifications required of audit committee members, the processes for appointment audit committee members (paragraphs 51 and 57 need more prominence).
 - The threat to audit quality of hiring and firing of auditors by management instead of audit committees should be given more prominence. Corporate legislation in South Africa provides for audit committees of public companies to be responsible for approving the appointment and independence of the entity's auditor intended to mitigate this threat.
- e) *Consultation:* whilst there should be an emphasis on *consultation* within a firm (paragraph 56), it is not always clear whether the engagement partner is expected to follow the advice provided and who is responsible where the advice provided is incorrect, or is unaware of or fails to take account of relevant facts, yet is followed by the engagement partner. We have also observed a measure of lack of self-confidence by auditors in exercising their judgement arising from the "culture of consultation" and possible sanctions by the firm.
- f) The *leadership of audit firms* (paragraph 47) - who "really" makes the decisions affecting all aspects of the audit business? Is it an auditor or a non-auditor? An emerging trend in multi-disciplinary firms providing significant advisory and other non-assurance services is for the appointment of a ("global") CEO's of such firms who are non-auditors who might not fully appreciate the importance of the independence requirements in ethics codes and auditing standards for auditors providing audit and assurance services.
- g) *Low balling in tenders* for audit engagements affects audit quality as auditors may cut corners to meet the "low" fees quoted. Pressures increased from clients with declining profit

margins following the global financial crisis, and audit perceived as being a “grudge buy”, similar to what was happening in the “pre-Enron” period.

- h) *Impact of ongoing legislative changes in jurisdictions:* Continual review and improvement of governance laws. Mechanisms needed to fully understand legal implications for client and audit, and to make changes as circumstances changes, may negatively affect audit quality if it takes two to three years to make important changes to legislation (time frames too long).

Attributes included but which merit further discussion or clarification

We have the following suggestions regarding factors where additional discussion or considerations could be included:

- i) The discussion on the perspectives of audit quality among stakeholders (paragraph 12 to 15) is not a true reflection of findings set out in Appendix 2. It seems that critical areas were robustness of the audit, independence, the engagement team’s competence and continuity and communications. However, this discussion seems to indicate that the stakeholders’ perceptions were focused on the cost of an audit and the time it takes to conduct an audit. In addition, paragraph 53 could be linked to other stakeholder’s involvement and undue fee pressures that might impair audit quality.
- j) Paragraph 87 could address the continuity of engagement team members, which appeared to be a concern of management in the perspectives of audit quality in Appendix 2.
- k) Paragraphs 109 and 110 indicate the drawbacks of use of IT in performing audits. However, the discussion is focused on the drawbacks, which then appears to indicate that audit firms should not use IT in performing audits. Perhaps if more advantages are explained the view may be more balanced.
- l) Paragraphs 119 and 120 indicate that the methodology and the software are one in the same: “these methodologies are sometimes in the form of audit software”. It should be clear that the software supports the methodology, but is not the methodology.
- m) Paragraph 122 indicates that using audit software distances the partners and the staff from the company being audited, which reduces time spent “on the floor”. However, as the environment evolves, new innovative audit techniques/tools should be identified to adapt to changes, which may not always involve “walking the floor”. This point should be highlighted.
- n) It should be highlighted in paragraph 163 that high quality financial statements contribute to improved audit quality as the auditor can focus on critical issues.
- o) The discussion on business practices and commercial law (paragraphs 209 to 212) is limited and could be explored further. In some countries, there may be a culture where unethical business practice, e.g. corruption, is widely accepted. In such conditions, conducting audits applying the expected ethics and values may be extremely challenging. The FW could provide guidance with respect to factors applied by auditors to manage engagements in such circumstances to ensure audit quality is still achieved.
- p) The document is focused on audits of financial statements, yet ISQC 1 is applicable to reviews, other assurance engagements and related services. Although there is a clear public interest with respect to audits of financial statements, assurance on other information will become more prevalent in the next few years and therefore it is important that quality for other assurance engagements is considered or discussed briefly in the document.

Question 2

Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged with governance), and other stakeholders? If not, which areas of the Framework should be revised and how?

Response:

- a) Overall, we believe that the FW should encompass a more balanced discussion of the contributions of all participating stakeholders to audit quality. While we acknowledge that the audit profession has primary responsibility for audit quality, as indicated earlier, there are many other stakeholders who can affect audit quality and their roles should be articulated more clearly and fully in the FW.
- b) The FW is easy for auditors, who are familiar with the technical terms and content to understand, however, other stakeholders such as investors, management and those charged with governance might find it difficult to comprehend. An executive summary or use of diagrams to illustrate the principles would also facilitate a better understanding of the document.
- c) A better balance in responsibility for audit quality will be obtained if it is broken down into different levels of stakeholders who might impact audit quality. These should include management, investors/ public sector stakeholders, audit committee, the entity and auditors. The roles and responsibilities of these different parties in enhancing audit quality should be documented in a simple and understandable manner.
- d) We suggest relocating the “Interactions” and “Contextual Factors” to earlier in the document, as these are the elements which are mostly impacted by other stakeholders, and underpin the audit engagement and have an impact on audit quality.
- e) The layout and approach should focus on being user friendly and enabling quick referencing, possibly with greater use made of diagrams¹. At the moment the FW is too lengthy and difficult to absorb.

Question 3

How do you intend to use the Framework? Are there changes that need to be made to the form or content of the Framework to maximize its value to you?

Response:

Envisaged uses of the Framework

National standard setter

- a) Consider in developing auditing standards and guidance for effective implementation to enhance their contribution to audit quality in the public interest.

Audit regulator

- b) Consider in the development and focus of Inspections Programmes and Engagements

Audit and assurance practitioners and other stakeholders

- c) Use as a basis for discussions with stakeholders about the meaning of audit quality and how this can be enhanced. Also discussions about how stakeholders might evaluate the quality of audit services provided by auditors
- d) Engaging with audit professionals and discussions in audit quality training sessions to consider how professional staff can further contribute to audit quality in the course of their audit engagements.

¹ Refer examples in PCAOB Paper: *Discussion on Audit Quality Indicators, May 15-16, 2103*

Changes that could to be made to the Framework

- a) The functionality of the FW is limited, as it is both lengthy and unwieldy. We suggest the FW itself should be:
- Simple, to encourage consistent application
 - Versatile, to support the evolution of audit quality as it is a dynamic concept
 - Succinct, to promote its use as a quick reference tool.
- b) It is important to understand how the FW factors could be used by auditors as a basis for evaluating the quality of an audit. When used by stakeholders other than auditors, tools may need to be developed to assist in identifying the relevant factors to use, since individual factors cannot be the sole measure of audit quality, but rather all relevant factors considered and evaluated collectively.

Contextual factors (impact on financial reporting, rather than quality of the audit)

- c) This section appears to be disconnected from the remainder of the FW since the discussion is focused on how contextual factors influence the *quality of financial reporting*, rather than the *quality of the audit*. If the section is intended to provide guidance for engaging with stakeholders regarding the impact of these aspects on the quality of the audit and skills and competencies of the audit team required, we believe that needs to be articulated more clearly.

Considerations relating to specific audits

Group audits

- d) Although there are some areas where group audits have been considered, for example 1.7.3 and 1.7.4, we believe that a separate sub-section should be dedicated to considerations relating to group audits, especially where these relate to global entities operating in many different legal jurisdictions.

Public Sector

- e) *Values, Ethics and Attitudes* – National level - Independence can be challenging if proper structures are not in place as to the financial independence of the Supreme Audit Institution (SAI), reporting lines of the SAI, appointment of the head of the SAI etc. If these are not properly established, the independence of the SAI could be tainted.
- f) *Values, Ethics and Attitudes* – National level – In developing countries, ethical issues are generally problematic, particularly in the public sector.
- g) *Knowledge, Experience and Time* – Engagement level – Public Sector is generally far more regulated and therefore more complex and the required level of technical competence is increased.
- h) Page 12 includes key terms for the public sector which is incorrectly placed as it is better placed with the “*considerations specific to public sector audits*” in section 5.1.

Audits of Smaller Entities

- i) *Values, Ethics and Attitudes* – Firm level – The focus on financial considerations i.e. profitability of the audit is far more prevalent. Smaller firms do not have the financial backing to support losses on audits.
- j) *Knowledge, Experience and Time* – Engagement level – Practitioners have more limited access to experts and restricts consultation opportunities.

- k) *Knowledge, Experience and Time* – Firm level – Due to limited access to technical resources, retaining the required level of knowledge of accounting and auditing standards is extremely difficult.
- l) *Audit Process* – Firm level – Due to limited technical resources, a methodology is unlikely to be defined. Furthermore, policies regarding EQCR reviews are unlikely to be in place, and depending on the mix of engagements in the client portfolio may not be necessary.
- m) *Contextual factors* – less complicated business practices and information systems are generally combined with less controls as well as an increased risk of management override of controls. In addition, the owner-manager’s focus is on the bottom line, and corporate governance matters are not a priority. Furthermore, a lack of accounting expertise, although the accounting framework is simpler, results in poor financial reporting. These matters may negatively affect audit quality.

Attributes that contain excessive detail

- n) We found the discussions in paragraphs 218 and 219 to be excessive and unnecessary. However, these issues are open-ended, and the list of challenges identified in the document is only minimal. It may be more appropriate to exclude this level of detail and merely stick to the fact that auditing estimates creates challenges.

Question 4:

What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?

Response:

- a) We recognise that the *Areas to Explore* have arisen from the development of the FW, which demonstrates its potential usefulness in identifying gaps and developing programmes to address these gaps. However given the importance of the audit quality project and the desire to move forward with a FW, these areas should be addressed in a separate forum and not linked to the further development of the FW.

| Area to explore | Comments | Priority |
|--|---|-----------------|
| Item 1 – guidance for assessing governance arrangements | This can be very useful; we need some benchmark that we can measure ourselves against. Will this guidance be applicable to audit services only or will it also cater for non-audit services within the audit firm? | Low |
| Item 2 – common understanding of capabilities | The International Education Standards (IES) are currently developing more clearly defined competencies for audit professionals. In South Africa, the SAICA already has a competency Framework for trainees. For other staff levels, this should be left to a firm’s Human Resource discretion as it this will depend on circumstance e.g. demand vs. supply and experienced staff appointed having the requisite skills. A guide would however be sufficient. | Low |
| Item 3 – information sharing with respect to engagement acceptance and continuance | In South Africa, before accepting a new engagement, the proposed auditor is required by the IRBA <i>Code of Professional Conduct</i> to request from the predecessor auditor, as to whether there are any professional reasons not to accept the engagement. However, audit firms are usually reluctant to provide information or specific working papers to assist the | Low |

| Area to explore | Comments | Priority |
|--|---|---------------|
| | <p>incoming audit firm with, for example, prior year misstatements.</p> <p>Confidentiality can be an issue and permission is required from the entity for the incoming auditor to seek to inspect audit working papers of the predecessor auditor.</p> | |
| Item 4 – audit inspection activities | <p>This exploration could include the following:</p> <ul style="list-style-type: none"> • An evaluation of whether public reporting on audit firm findings has resulted in improved audit quality. • Considering whether disclosing details of disciplinary actions, including the identity of the practitioner and the reason for the disciplinary, would contribute the enhancement of audit quality. • The results of inspections can be used as a benchmark across countries and audit firms to evaluate the consistency of audit quality. | Med |
| Item 5 – national authorities exchanging information | <p>This may be in the best interest of the profession towards improving quality.</p> <p>IFIAR provides a forum for audit regulators to share findings regarding audit quality trends and best practices identified from inspections of audit firms and engagements.</p> | Low |
| Item 6 – “root cause” analysis, best practices | <p>This is currently addressed through various forums. Within certain firms, outcomes of reviews are analysed to identify root causes and these are addressed. Perhaps there could be improved information sharing on root causes between the audit firms and with the regulators.</p> <p>This action would assist in addressing the most immediate reasons for poor quality. This type of “best practice” framework would assist audit firms to immediately assess their “culture of quality” against other audit firms have implemented current quality standards and have it work for them.</p> <p>This should be given priority because while investigations into possible audit failures are likely to identify areas of audit weaknesses, these are also relevant to areas of the Code of Ethics which may require revision. Greater examination (or formal analysis) of the threat/s encountered and an understanding of why certain safeguards could not be applied, would lead to a more stringent code.</p> <p>Information gathering and sharing will be a challenge.</p> | High |
| Item 7 – revisions to auditor’s reports | <p>The Auditor-General SA (AGSA) has shared its concerns for the need to improve the informational value of auditor’s reports with the IAASB and IRBA. The public sector already adds more value to users with extra audit disciplines but will be aligned to international reporting templates once the IAASB reporting project becomes available.</p> <p>The IAASB reporting improvement project is already underway and expect to issue ED’s for ISA 701 and ISA 700 in August 2013 that will be exposed simultaneously in South Africa with a view to adoption.</p> | High |
| Item 8 – improved two-way communication | <p>Generally, improved two way communication between all stakeholders is necessary. Additional guidance may be</p> | Medium |

| Area to explore | Comments | Priority |
|--|--|---------------|
| between auditors and regulators | <p>useful to support this.</p> <p>Other regulators often seek assurance from auditors, usually regarding compliance by regulated entities with regulatory requirements, by reporting on returns of regulated entities and instances of non-compliance. However, the ISAs are not always suitable or do not address the particular requirement.</p> <p>There is a need for a Standard on Compliance Engagements to underpin the more detailed regulatory reporting requirements.</p> <p><i>Public sector perspective</i></p> <p>The definition of regulators could be elaborated on. In the public sector the Legislatures and Parliament are considered regulators as they determine the legislation and regulatory environment, supported by the ASB and National Treasury, in developing accounting frameworks and standards that might extend the scope of public sector audits to include matters such as internal control.</p> <p>Furthermore, key factors that ensure consistency between public and private sector audit regulators to enhance audit quality should be addressed.</p> | |
| Item 9 – greater international harmonisation in the role of audit committees | <p>Providing audit committees with tools to evaluate the quality of the audit may be useful.</p> <p>This will be useful over and above the requirement of the International Corporate Governance Codes for Audit Committees and those charged with governance.</p> | Medium |
| Item 10 – audit committees providing greater transparency on their oversight | <p>Consider whether this is not already a requirement in certain countries, e.g. reporting requirements for audit committees in the annual report of issuers are contained in the South African Companies Act and the Listings Requirements of the Johannesburg Stock Exchange.</p> | Medium |

Additional areas to explore

- b) Whether audit inspectors seeking views of those charged with governance on the quality of the audit could provide additional insight and value to inspection activities.
- c) Whether audit firm transparency reports have assisted with the selection and appointment of audit firms, and the impact this might have had on overall audit quality.
- d) Compliance with deadlines: In the public sector the deadlines are legislated, which places enormous pressure on the auditors to complete audits on time. Pressure to meet tight deadlines could affect the quality of the audit.
- e) The accountability of those charged with governance should be emphasised. They should report in terms of legislation and relevant corporate governance requirements in their jurisdictions, on measures taken to address and improve audit quality.
- f) Interactions between management, auditors and regulators should be defined as there could be different regulators for different regulated entities or purposes with different needs for and audit or other assurance from an auditor.
- g) The role of oversight bodies and how they use auditors' reports should be explored.
