

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Audit Quality—Summary of Main Threats to Audit Quality and Possible Actions to Address Them

DRAFT

FOR ILLUSTRATIVE PURPOSES ONLY

SUMMARY OF MAIN THREATS TO AUDIT QUALITY AND POSSIBLE ACTIONS TO ADDRESS THEM

AUGUST 2011

Note

As part of its project to develop an Audit Quality framework (“Framework”), the IAASB is exploring the value of identifying the main threats to audit quality – and possible actions to address them – with respect to the main elements of the Framework, which are:

- Key Stakeholder Interactions;
- Contextual Factors;
- Input Factors; and
- Output Factors.

This summary is provided for illustrative purposes and is not intended to be comprehensive. It has not been discussed in detail by the IAASB.

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

I. Key Stakeholder Interactions

| # | Interactions | Threats to Audit Quality | Possible Actions |
|----|---|--|---|
| 1. | Auditors and management | <ul style="list-style-type: none"> • No legal or regulatory requirement for management to provide auditors with all information and access necessary for auditors to properly carry out their audits. • Management unwillingness to disclose information to auditors for confidentiality or other reasons. • Audit perceived by management as a low priority compliance exercise. • Poor working relationship between auditors and management. • Insufficient understanding of the entity's business within the engagement team. • Continual changes in engagement team. | <ul style="list-style-type: none"> • Strengthen the legal and regulatory framework surrounding the audit. • Mutual efforts by engagement partners and management to develop relationship and enhance cooperation and dialogue. • Adequate audit planning, including timely liaison by auditors with management regarding information requests and other support required. • Focus by auditors on maximizing engagement team continuity. |
| 2. | Auditors and those charged with governance (TCWG) | <ul style="list-style-type: none"> • Insufficient emphasis placed on performing a robust audit; auditors too familiar with management. • Insufficient auditor communication with TCWG about audit issues. • Poor timing of communications | <ul style="list-style-type: none"> • Change of engagement partner to increase effort placed on performing a robust audit. • Mutual efforts by engagement partner and TCWG to develop relationship and enhance |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|---------------------|---|--|
| | | <p>with TCWG.</p> <ul style="list-style-type: none"> • Poor working relationship between auditors and TCWG. • Lack of interest amongst TCWG in the audit. • Lack of independence amongst TCWG or inadequate financial literacy skills amongst them. | <p>cooperation and dialogue.</p> <ul style="list-style-type: none"> • Strengthen the corporate governance regime to ensure clear responsibilities for TCWG regarding oversight of the audit. • Strengthen the corporate governance regime in terms of requirements for independence and financial literacy skills. • Audit planning that provides for adequate dialogue with TCWG throughout the audit. |
| 3. | Management and TCWG | <ul style="list-style-type: none"> • Poor working relationship between management and TCWG. • Management do not inform TCWG about business risks and financial reporting issues. • Poor tone at the top from TCWG. • Lack of independence from management by TCWG. • Inadequate professional skepticism demonstrated by TCWG. • Management compensation policies that foster aggressive accounting practices and discourage reporting | <ul style="list-style-type: none"> • Mutual efforts by management and TCWG to resolve conflicts and enhance the relationship. • Regular meetings between management and TCWG. • Messages and other actions from TCWG emphasizing importance of audit quality and high-quality financial reporting. • Strengthen corporate governance regime relative to independence requirements for TCWG. • Recruitment of experienced members of TCWG with the |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|---------------------------|---|--|
| | | by management of anticipated difficulties in meeting agreed targets. | <p>authority to challenge management.</p> <ul style="list-style-type: none"> Adoption of best practices by TCWG in setting management compensation policies that do not emphasize short-term results. |
| 4. | Auditors and regulators | <ul style="list-style-type: none"> Weak regulatory framework surrounding audit. Lack of respect between auditors and audit regulators. A compliance approach to audit without regard to spirit and intent of professional standards. IFIAR principles not applied by regulators, e.g. insufficient staff of appropriate competence. | <ul style="list-style-type: none"> Strengthen regulatory framework surrounding audit based on international best practices. Build respect through enhanced cooperation and dialogue. Adherence by auditors to spirit and intent of professional standards. Recruitment of competent and experienced individuals to join regulatory inspection teams. |
| 5. | Management and regulators | <ul style="list-style-type: none"> Lack of dialogue between management and regulators when there are matters of regulatory significance. | <ul style="list-style-type: none"> Strengthen regulatory framework surrounding communication of matters of significance to regulators. |
| 6. | Regulators and TCWG | <ul style="list-style-type: none"> Lack of dialogue between TCWG and regulators when there are matters of regulatory significance. | <ul style="list-style-type: none"> Strengthen regulatory framework surrounding communication of matters of significance to regulators. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Interactions | Threats to Audit Quality | Possible Actions |
|----|--|--|---|
| 7. | Auditors and financial statements users | <ul style="list-style-type: none"> • Passive user interest in the audit. • Poor user appreciation of the importance and value of the audit. • Weak regulatory framework that does not provide avenues for user interaction with auditors. | <ul style="list-style-type: none"> • Communications and educational initiatives to enhance user awareness of the role of the audit and the role they can play in enhancing AQ. • Strengthen regulatory framework to provide ways for users to better interact with auditors on significant audit matters. |
| 8. | TCWG and financial statement users | <ul style="list-style-type: none"> • Weak corporate governance regime. • Inadequate reporting to users by TCWG regarding how they have fulfilled their governance responsibilities. | <ul style="list-style-type: none"> • Strengthen corporate governance regime based on international best practices to define responsibilities of TCWG. • Enhance framework for reporting by TCWG to users. |
| 9. | Audit regulators and financial statement users | <ul style="list-style-type: none"> • Reports on findings of inspections by audit regulators not published. | <ul style="list-style-type: none"> • Adopt international best practices for communicating inspection findings to the public. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

II. Contextual Factors

| # | Contextual Factors | Threats to Audit Quality | Possible Actions |
|---------------------------|--|---|---|
| <i>Business Practices</i> | | | |
| 1. | General legal and regulatory environment | <ul style="list-style-type: none"> • Weak business laws. • Lack of formality around business transactions. • Significant proportion of business conducted with related parties. • Weak securities laws and regulations regarding protection of investor rights. • Weak legal and regulatory framework surrounding audit. • Excessive litigation against auditors. | <ul style="list-style-type: none"> • Legislative action to strengthen legal framework governing the conduct of business. • Educational programs within business community to raise levels of awareness regarding the importance of formalizing terms and conditions of transactions. • Development of appropriate audit responses, including enhanced professional skepticism and use of more experienced staff on audits. • Legislative and regulatory actions to strengthen framework for investor protection. • Legislative and regulatory actions to strengthen framework surrounding audit, including establishment of: <ul style="list-style-type: none"> ○ Clear responsibilities for management regarding the preparation of financial |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Contextual Factors | Threats to Audit Quality | Possible Actions |
|---|--|---|--|
| | | | <ul style="list-style-type: none"> statements and the audit; and ○ Robust punitive mechanisms with respect to both auditors and management when failing to fulfill their respective obligations. |
| 2. | Multi-national entities | <ul style="list-style-type: none"> • Weak group-wide controls. | <ul style="list-style-type: none"> • Implementation of appropriate entity-level controls, including adoption of group-wide controls in a group context. |
| <i>Corporate Governance Requirements</i> | | | |
| 3. | Corporate governance framework | <ul style="list-style-type: none"> • Weak corporate governance framework. | <ul style="list-style-type: none"> • Legislative or regulatory actions to adopt international corporate governance best practices. • Educational programs and communications to raise levels of awareness amongst TCWG regarding the importance of their role relative to audit quality. |
| <i>The Applicable Financial Reporting Framework</i> | | | |
| 4. | The applicable financial reporting framework | <ul style="list-style-type: none"> • Poorly defined financial reporting framework. • Overly principles-based/rules-based financial reporting framework. | <ul style="list-style-type: none"> • Legislative or regulatory actions to adopt international financial reporting best practices. • Standard setters to maintain an appropriate focus on principles |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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| | | <ul style="list-style-type: none"> • Overly complex financial reporting framework. • Very tight reporting deadlines. | <p>when setting financial reporting standards.</p> <ul style="list-style-type: none"> • Actions by standard setters to simplify overly complex financial reporting standards. • Regulatory action to ease reporting deadlines. • Enhanced dialogue between entity and investors to better manage expectations regarding timing of release of results. |
| <i>Industry and Information Technology</i> | | | |
| 5. | Industry | <ul style="list-style-type: none"> • Areas presenting significant auditability issues, such as fair value accounting estimates. • Industries with complex regulatory environments. | <ul style="list-style-type: none"> • Development of appropriate audit responses, including enhanced professional skepticism, use of more experienced staff on audits, and use of experts. • Industry specialist units within the firm. • Regular training provided in industry issues. |
| 6. | Information technology | <ul style="list-style-type: none"> • Entities' use of highly complex IT systems. • Weak general IT and application controls within entities. | <ul style="list-style-type: none"> • Regular training provided in IT issues. • Implementation and maintenance by entities of appropriate general |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Contextual Factors | Threats to Audit Quality | Possible Actions |
|---|--|--|---|
| | | <ul style="list-style-type: none"> • Disruptive IT-related events within entities and audit firms, such as introduction of, or migration to, new technology. • Over-reliance by auditors on electronic communications. • Partner reviews performed electronically off-site. | <p>IT and application controls.</p> <ul style="list-style-type: none"> • Development of appropriate audit responses, including enhanced professional skepticism, use of more experienced staff on audits, use of computer-assisted audit techniques, and use of experts. • Appropriate training and communications within firms emphasizing importance of exercising appropriate professional judgment when using audit software. |
| <i>The Status of Auditors and the Underlying Educational Environment for Accountants and Auditors</i> | | | |
| 7. | Status of auditing profession | <ul style="list-style-type: none"> • Weak institutional support for auditors. • Composition of TCWG lacking sufficient independent and competent individuals capable of setting the right culture for audit quality. | <ul style="list-style-type: none"> • Legislative or regulatory actions to empower auditors to discharge their responsibilities in a robust way. • Recruitment by entity of experienced individuals to be part of TCWG. |
| 8. | The educational environment for accountants and auditors | <ul style="list-style-type: none"> • Weak educational system for accountants and auditors. • Weak incentives for individuals to pursue career within the auditing | <ul style="list-style-type: none"> • Institutional actions to strengthen educational system for accountants and auditors. • Audit firms use competency |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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| | | profession. <ul style="list-style-type: none"> • Low status for the auditing profession in the national environment. | frameworks embedded in IESs. <ul style="list-style-type: none"> • Adoption by professional accountancy bodies of IESs. • Actions by firms and professional accountancy bodies to raise levels of awareness about attractiveness of the profession. • Actions by firms to enhance career incentives. |
| <i>Broader Cultural Issues</i> | | | |
| 9. | Deference to authority | <ul style="list-style-type: none"> • Strong cultural propensity for individuals to defer to authority. | <ul style="list-style-type: none"> • Actions by firms and professional accountancy bodies to educate and train auditors, particularly with regard to the application of professional skepticism. • Transnational staff secondments within audit firms. • Sharing of experiences and best practices within international firms to overcome the challenges. |
| 10. | Transparency | <ul style="list-style-type: none"> • Confidentiality laws that conflict with the proper conduct of the audit. | <ul style="list-style-type: none"> • Legislative action to require disclosure to auditors. • Active role for TCWG. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

III. Input Factors

1. The Firm's Leadership Creates a Culture where Audit Quality Is Valued

| # | Indicators | Threats to Audit Quality | Possible Actions |
|----|--|---|---|
| 1. | Appropriate corporate governance arrangements are in place. | <ul style="list-style-type: none"> Audit does not provide the main source of income to the firm and audit is not well represented within the firm's leadership. | <ul style="list-style-type: none"> Audit firms improve governance arrangements; for example, appointment of independent, non-executive members to their governing boards. |
| 2. | The firm promotes the personal characteristics essential to audit quality. | <ul style="list-style-type: none"> Recruitment, promotion and reward systems give little or no recognition to the personal characteristics essential to audit quality. | <ul style="list-style-type: none"> Promote a culture that recognizes and rewards high quality work. Evaluate partners and staff using competency frameworks that include audit quality. Recruit individuals of integrity who have the capacity to develop the necessary competencies. Recognize and reward the development and maintenance of competence and commitment to ethical principles. Emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|---|--|--|
| | | | competence and capabilities. |
| 3. | Financial considerations do not drive actions and decisions that have a negative effect on audit quality. | <ul style="list-style-type: none"> • Business strategy of the firm that is geared more towards promoting its commercial interests than achieving quality on its engagements. • Firm rapidly expanding / contracting. • Firm leadership unwilling to invest in audit quality. • Over-emphasis on marketing non-audit services. • Internal training overly focused on improving client service at the expense of necessary training in technical competence and appreciation of the public interest aspect of auditing. • Client pressure or intimidation (e.g., threat of dismissal or litigation, or pressure to reduce inappropriately the extent of work performed in order to reduce fees.). • Quoting fees that are so low that it may be difficult to perform the engagement in accordance with applicable technical and | <ul style="list-style-type: none"> • The leadership of the audit function has sufficient input into overall firm management decisions. • Over-emphasis is not given to winning audit appointments and on the retention of audit clients at the expense of the quality of audit judgments. • Over-emphasis is not given to marketing non-audit services. • There is not excessive cost cutting (including by reducing partners and staff) in the audit practice during times of economic downturn that damage the provision of audit quality. • Internal training is not overly focused on improving client service at the expense of necessary training in technical competence and appreciation of the public interest aspect of auditing. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|--|--|---|
| | | professional standards for that price. | |
| 4. | Partners and staff have sufficient time and resources to deal with difficult issues as they arise. | <ul style="list-style-type: none"> • Business strategy places undue emphasis on engagement profitability at the expense of quality. • Client pressure to complete engagements within tight deadlines. • Excessive workloads placed on individual partners and staff. • Assigning the most competent partners and staff to the firm's largest and most prestigious clients at the expense of the firm's riskier clients. • Few partners to properly supervise work of staff. | <ul style="list-style-type: none"> • Promote an internal culture recognizing that quality is essential in performing engagements. • Considering audit risk when assigning appropriate engagement teams. • Monitor the workload and availability of engagement partners and staff so as to enable these individuals to have sufficient time to adequately discharge their responsibilities. • Agree on realistic time frames with clients. |
| 5. | Partners are accessible both to their own staff and to management and TCWG of the entities they audit. | <ul style="list-style-type: none"> • Excessive workloads placed on partners. • Business strategy that encourages partners to dedicate excessive amounts of time seeking new business. | <ul style="list-style-type: none"> • Assign engagements to partners in such a way as to allow sufficient access to them by engagement staff, management and TCWG. • Promote an internal culture that emphasizes the importance of partners spending adequate time on engagements. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|---|--|--|
| 6. | The firm provides partners and staff with access to high-quality technical support. | <ul style="list-style-type: none"> • Inadequate resources invested in high quality technical support. • Poorly developed information infrastructure. | <ul style="list-style-type: none"> • Provide sufficient resources to enable appropriate consultation to take place. • Develop an information infrastructure to: <ul style="list-style-type: none"> ○ Support audit judgments; ○ Track independence issues; and ○ Plan and effectively manage the rotation of partners and managers on audit engagements. |
| 7. | The firm promotes a culture of consultation on difficult issues. | <ul style="list-style-type: none"> • The firm culture does not encourage consultation on difficult issues. • Lack of investment in experienced resources to provide support to engagement teams. | <ul style="list-style-type: none"> • Possible actions include the following: <ul style="list-style-type: none"> ○ Consult appropriately on difficult or contentious issues. ○ Provide sufficient resources to enable appropriate consultation. ○ Document consultations. ○ Implement the outcome of consultations. • Require, for appropriate |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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|----|--|--|--|
| | | | <p>engagements, an engagement quality control review.</p> <ul style="list-style-type: none"> Deal with and resolve differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer. |
| 8. | Robust systems exist for making client acceptance and continuance decisions. | <ul style="list-style-type: none"> Weak or non-existent policies and procedures addressing acceptance and continuance of client relationships and specific engagements. | <ul style="list-style-type: none"> Accept and continue client relationships and specific engagements only when appropriate. Client acceptance and continuance systems focused on integrity of owners, TCWG and management. |
| 9. | Audit quality is monitored and appropriate consequential action is taken. | <ul style="list-style-type: none"> Inadequate resources (quantity and quality) for monitoring of audit quality. Inadequate responses to weaknesses identified. Weak or non-existent monitoring process for network firms. | <ul style="list-style-type: none"> Monitor the firm's system of quality control so that it is relevant, adequate, and operating effectively. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

2. The Knowledge, Experience and Personal Attributes and Values of Audit Partners and Staff

| # | Indicators | Threats to Audit Quality | Possible Actions |
|----|---|--|--|
| 1. | Partners and staff understand their clients' business. | <ul style="list-style-type: none"> • Understanding the business insufficiently emphasized in the firm's culture and methodology. • The engagement team does not possess the expertise in the client's business. • Lack of support for specialist industries within the firm. • Poor staff retention. | <ul style="list-style-type: none"> • Provide for sufficient personnel with the necessary competence and capabilities, including calling upon experts where necessary. • A reasonable degree of continuity is achieved in the engagement team from one audit to the next. • Development of industry specialist groups. |
| 2. | Staff performing detailed "on-site" audit work have sufficient experience and are appropriately supervised by partners and more senior staff. | <ul style="list-style-type: none"> • Lack of partner involvement in the audit process. • Weak arrangements for review and supervision. • Lack of experienced engagement team members on site to direct and supervise the audit work. | <ul style="list-style-type: none"> • Active involvement of partners in the audit. • Establish within the firm's methodology clear requirements relating to supervision and review and implement them in practice. |
| 3. | Partners and more senior staff provide less experienced staff with timely appraisals and appropriate coaching or "on-the-job" training. | <ul style="list-style-type: none"> • Senior engagement team members too busy to assist personal development of less experienced staff. • Appraisal process does not focus on audit quality issues. • Undertaking performance | <ul style="list-style-type: none"> • Provide timely appraisals, appropriate coaching or "on-the-job" training, all focused on enhancing audit quality. • Appraising experienced staff on the quality of their coaching or "on-the-job" training. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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| | | appraisals long after engagement completion. | |
| 4. | Partners and staff have integrity, act objectively and comply with relevant ethical requirements. | <ul style="list-style-type: none"> • Partners and staff too closely aligned with helping the client achieve its commercial goals. • A culture exists of bowing to client pressure or intimidation (e.g. threat of dismissal or litigation). • Undue time pressures to complete engagements. • Partners and staff have been associated with the client for many years. | <ul style="list-style-type: none"> • Firms encourage adherence to the principles underlying ethical requirements that apply to auditors. • Comply with the IESBA Code. • Actions to address the familiarity threat caused by long association. |
| 5. | Partners and staff demonstrate skepticism and professional competence. | <ul style="list-style-type: none"> • Firms are not committed to staff development programs • Inadequate coaching on-the job training for engagement team members. • Complex applicable financial reporting frameworks apply to the client's industry. • Lack of training / technical support to allow partners and staff to understand applicable financial reporting framework. | <ul style="list-style-type: none"> • Firms have staff development programs and facilitate continued professional development. • Firms adopt the IESs and embed them in their training and staff development systems. • Firms provide training / technical support to allow partners and staff to understand applicable financial reporting framework. • Professional competence, including skepticism, emphasized |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

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| | | <ul style="list-style-type: none"> • The importance of skepticism not emphasized at the firm level. • Partners and staff do not demonstrate a willingness to understand management motivations and challenge management assertions. • Lack of leadership from the engagement partner, e.g., from active involvement in audit planning meetings. | <ul style="list-style-type: none"> • in competence frameworks used for partner and staff evaluation. • Coaching culture developed to nurture necessary auditor values and attributes. |
| 6. | Sufficient training is given to audit partners and staff on audit, accounting and, where appropriate, specialized issues. | <ul style="list-style-type: none"> • Insufficient investment by the firm in specialized industries. • Inadequate time and resources devoted to training. • Lack of on-site involvement of senior engagement team members in directing, supervising and reviewing the audit work. | <ul style="list-style-type: none"> • Emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities. • Provide on-site direction and supervision of less experienced engagement team members by more experienced team members, thus providing appropriate “on-the-job” training. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

3. The Effectiveness of the Audit Process

| # | Indicators | Threats to Audit Quality | Possible Actions |
|----|---|--|---|
| 1. | The engagement team is properly structured and there is adequate and timely involvement of partners and experienced staff. | <ul style="list-style-type: none"> • The engagement team does not possess the capabilities necessary to properly carry out the engagement. • Senior personnel having a long association with the client. • Partners and managers too busy with other activities to be actively involved in the audit. | <ul style="list-style-type: none"> • Provide for engagement teams to be adequately resourced. • Use specialists and auditor experts where needed. • Rotate partners and staff in accordance with professional standards and applicable legal and regulatory requirements. • Firm monitors partner and manager time so that they are not “over-stretched.” • Active involvement of partners and managers in audit planning. |
| 2. | The engagement team makes proper use of technology. | <ul style="list-style-type: none"> • Excessive reliance on pre-programmed audit procedures when planning and performing the audit work. • Excessive reliance on e-mail for audit evidence. | <ul style="list-style-type: none"> • Tailor audit procedures to the engagement circumstances. • Minimize reliance on e-mail for audit evidence. |
| 3. | The audit methodology: <ul style="list-style-type: none"> • Does not discourage individual team members from thinking creatively, applying skepticism, and | <ul style="list-style-type: none"> • Over-emphasis on compliance with firm’s methodology at the expense of appropriate professional judgment. | <ul style="list-style-type: none"> • Firms emphasize the use of professional judgment and provide training and support to partners and staff. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Indicators | Threats to Audit Quality | Possible Actions |
|----|--|--|---|
| | <p>exercising judgment.</p> <ul style="list-style-type: none"> • Requires an effective supervision and review of audit work. • Requires appropriate audit documentation. | <ul style="list-style-type: none"> • Lack of involvement of the engagement partner in risk assessment and planning processes, and in directing, supervising and reviewing the audit work. • Insufficient emphasis on importance of documenting significant professional judgments. • Excessive prescription in methodologies reduce flexibility and leads to auditing being seen as a “box-ticking” exercise. • Insufficient emphasis given to tailoring audit procedures to circumstances. • New staff may spend their time learning how to use the technology (because the methodologies require extensive training), rather than how to audit. • Partners and managers review audit work from remote locations. | <ul style="list-style-type: none"> • The application of professional judgment embedded in appraisal, promotion and remuneration processes. • Partners and managers encouraged to review audit work “on-site.” |
| 4. | <p>There is effective engagement with the auditors of other components in the group (where applicable).</p> | <ul style="list-style-type: none"> • Ineffective engagement planning for group audits. • Poor communications with component auditors. | <ul style="list-style-type: none"> • Emphasis placed on the importance of effective engagement planning for group audits. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Indicators | Threats to Audit Quality | Possible Actions |
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| | | <ul style="list-style-type: none"> • Limitations on access to component auditors, whether imposed by management or by circumstances. | <ul style="list-style-type: none"> • Relationships with component auditors developed through visits and other forms of communication. • Discussion of issues regarding access to component auditors with management or TCWG of the entity. |
| 5. | There is effective engagement with the client's internal auditors (where applicable). | <ul style="list-style-type: none"> • Ineffective engagement planning. • Poor communications with internal auditors. • Over reliance on internal auditors. | <ul style="list-style-type: none"> • Relationship with internal audit discussed with TCWG. • Regular communication with internal auditors. |
| 6. | The audit process is adapted to developments in professional standards and is responsive to regulatory inspection findings. | <ul style="list-style-type: none"> • Lack of resources to support the audit methodology function. • Lack of timely updates to the audit methodology in response to developments in professional standards. • Disregard for regulatory inspection findings. | <ul style="list-style-type: none"> • Provide adequate resources to support the audit methodology function. • Respond on a timely basis to developments in professional standards. • Firm leadership to give due recognition to the importance of responding constructively to regulatory inspection findings, including taking steps where necessary to improve the audit process. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

IV. Output Factors

1. The Reliability of Audit Reporting to Users of Audited Financial Statements

| | Indicator | Threats to Audit Quality | Possible Actions |
|----|---|--|---|
| 1. | Audit reports are written in a manner that conveys the auditor's opinion on the financial statements. | <ul style="list-style-type: none"> • Audit reports that are not appropriate in the circumstances, e.g., if they are not supported by sufficient appropriate audit evidence. • Poor quality financial statements, e.g. errors and omissions or unclear disclosures. | <ul style="list-style-type: none"> • Increase scope of audit inspections. • Increased disciplinary action against auditors. |

2. The Quality and Usefulness of Audit Communications to TCWG

| # | Indicators | Threats to Audit Quality | Possible Actions |
|----|--|---|--|
| 1. | Communications with TCWG include information about: <ul style="list-style-type: none"> • The scope of the audit. • The threats to auditor objectivity. • The key risks identified. • Judgments made in reaching the audit opinion. • The qualitative aspects of the entity's accounting and reporting and potential ways of improving | <ul style="list-style-type: none"> • Inadequate engagement with TCWG during the audit. • Lack of an effective two-way dialogue between the auditor and TCWG. • Inadequate discussion of key risk areas and significant audit findings. | <ul style="list-style-type: none"> • Changes in legislation or corporate governance codes regarding responsibilities of TCWG. • Changes in auditing standards regarding responsibilities to report findings to TCWG. • Audit firms and TCWG work to effective two-way dialogue. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

| # | Indicators | Threats to Audit Quality | Possible Actions |
|---|--|--------------------------|------------------|
| | financial reporting. <ul style="list-style-type: none"> • Insights into the entity's financial reporting practices. • Recommendations for improvement to the entity's financial reporting process. | | |

3. The Quality and Usefulness of Audit Communications to Management

| | Indicators | Threats to Audit Quality | Possible Actions |
|----|--|---|---|
| 1. | Communications with management include findings about: <ul style="list-style-type: none"> • Misstatements in the financial statements. • Deficiencies in internal control. • Perspectives on industry issues and trends and opportunities for improvement. • Observations on regulatory matters. | <ul style="list-style-type: none"> • Non-communication or ineffective communication to management regarding identified misstatements and deficiencies in internal control. | <ul style="list-style-type: none"> • Changes in auditing standards regarding responsibilities to report findings to management. • Audit firms work to improve communications with management. |

IAASB CAG PAPER

IAASB CAG Agenda (September 2011)

Agenda Item C.2

Summary of Main Threats to Audit Quality and Possible Actions to Address Them

4. Transparency Reports

| # | Threats to Audit Quality | Possible Actions |
|----|--|--|
| 1. | <ul style="list-style-type: none">Useful information is lost by “boiler plate” wording.Transparency reports are viewed by the firms as marketing documents. | <ul style="list-style-type: none">Firms take the opportunity to highlight particular aspects of their arrangements.Including transparency reports within the scope of internal and external monitoring processes. |