



International Auditing
and Assurance
Standards Board

529 Fifth Avenue, 6th Floor, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.iaasb.org

Meeting: IAASB Consultative Advisory Group
Meeting Location: New York
Meeting Date: September 11, 2012

Agenda Item B

Audit Quality—Report Back and Issues and IAASB Task Force Proposals

Objectives of Agenda Item

1. To provide a report back on proposals of the Representatives on this project as discussed at the September 2011 CAG Meeting.
2. To consider the first full draft ("Consultation Draft – Version 1") of the proposed International Audit Quality (AQ) Framework ("Framework").

Papers to Be Referred to during Discussion

3. The discussion on this topic will follow the structure of this CAG Paper. Within this paper, reference is made to **Agenda Item B.1**, the revised Consultation Draft, to facilitate the discussion. This is the same document that will be considered by the IAASB the week after this CAG meeting. Given the extent of the changes from the first draft considered by the CAG in September 2011 ("CAG Draft"), a marked version is not provided.
4. Reference is also made to **Agenda Item B.2**, an abridged version for audit committees, in relation to the discussion of Issue F below.

Project Status and Timeline

5. The CAG last considered this project at its September 2011 meeting.
6. The IAASB held a preliminary discussion on the topic at its December 2009 meeting. At its June and December 2010 meetings, the IAASB discussed the objectives and scope of a project on AQ, including the development of a thought piece as an introduction to substantive work on the topic. The thought piece was published in January 2011.
7. At its March 2011 meeting, the IAASB agreed that the objective of the project should reflect the holistic approach to the project and emphasize the public interest as follows:

To establish in the public interest an international framework that describes audit quality holistically, including:

- (a) The influences of input, output and context factors;
- (b) Stakeholders' varying perspectives on audit quality; and

- (c) The importance of relationships between auditors and other key participants in the financial reporting supply chain (i.e., management, those charged with governance, investors and regulators), which influence audit quality.
8. The IAASB considered a “straw man” of the Framework in June 2011. Subsequently, the Task Force developed the CAG Draft for purposes of seeking input from the CAG in September 2011 and to support wider outreach and collaboration (“outreach phase”). During Q3 and Q4 2011, in addition to obtaining input from the CAG, discussions were held with a number of groups including:
- World Bank
 - International Organization of Securities Commissions (IOSCO)
 - International Corporate Governance Network (ICGN)
 - Focus group of academics
 - Forum of Firms
 - IFAC Small and Medium Practices (SMP) Committee

The outreach phase was very successful in providing a wealth of views and demonstrated considerable interest in the project. Appendix 1 includes a summary of the main comments received from stakeholders during the outreach phase and the Task Force’s proposed responses.

9. At its September 2011 meeting, the IAASB received a brief update on the progress of the Task Force’s outreach activities on the project. At its December 2011 meeting, the IAASB considered the main comments received from stakeholders on the CAG draft during the outreach phase and the Task Force’s proposals in response to them.
10. In July 2012, in advance of a Task Force meeting that month, the Task Force Chair and staff held a teleconference with the CAG Audit Quality Working Group (WG) to obtain the WG’s reactions to, and comments on, a revised draft of the Framework. The Task Force considered the WG’s input in further refining the draft.
11. The current plan is that the Framework will be discussed at the September 2012 IAASB meeting and an updated version issued for public consultation following the December 2012 IAASB meeting.
12. Appendix 2 to this paper provides a project history, including links to the relevant CAG documentation.

September 12–13, 2011 CAG Discussion

13. Below are extracts from the minutes of the September 2011 CAG meeting and an indication of how the project Task Force or IAASB has responded to the Representatives’ comments.

Representatives’ Comments	Task Force/IAASB Response
Mr. Hallqvist commented that the paper appears to have been developed in the context of the one-tier board structures that are common in the United States (U.S.) and	Point noted. The section on corporate governance has been

Representatives' Comments	Task Force/IAASB Response
<p>the United Kingdom (U.K.). He noted that two-tier board structures more clearly separate owner representatives from management, and therefore create fewer conflicts of interest in the governance structure.</p>	<p>drafted to accommodate different structures.</p> <p>See paragraphs 212-218 of Agenda Item B.1.</p>
<p>Mr. Diomeda suggested that the paper is too long for small and medium sized practices (SMPs) to easily use, and that the framework is too long for incorporation into requirements. He asked if there would also be a quality framework for other assurance engagements, such as review and compilation engagements.</p>	<p>Point taken into account.</p> <p>The Task Force believes it is necessary to first develop the complete Framework before determining how best it could be packaged. In this regard, the Task Force is presenting three suggestions for packaging for the CAG's consideration (see Issue F below) and is seeking views on those ideas and whether there are other options that could be considered.</p> <p>The Task Force is not planning to develop a quality framework for other assurance engagements, such as review and compilation engagements, but observes that many of the same factors would likely apply.</p>
<p>Mr. Hallqvist noted that who nominates the auditor is also important and that it is preferred that an independent audit committee be responsible for doing so. He also noted that cost is rarely the key issue for audit committees.</p>	<p>Point taken into account.</p> <p>While a number of jurisdictions require audit committees to appoint auditors, it is not a universal practice. The Consultation Draft acknowledges the importance of audit committees actively considering AQ when appointing or re-appointing auditors, and the important role they play in considering and approving audit fees.</p> <p>See paragraphs 215 and 12 of Agenda Item B.1.</p>
<p>Mr. Attolini noted that the IFAC SMP Committee supports the audit quality project and that the development of tools to address audit quality was important. He believed the IAASB is aware of the need to ensure that the final audit quality framework addressed SMP needs. He commented that SMPs share many issues with larger audit practices, though some issues are different, such as the involvement of those charged with governance in management, in many cases the performance of the audit directly by the partner without additional staff and the importance of lenders as</p>	<p>Support noted.</p> <p>The Framework is intended to be of relevance to large and small firms alike. Considerations specific to smaller audits and smaller firms have been identified in Section 7 of the Consultation Draft. The Draft Framework will be discussed by the IFAC SMP Committee in October 2012.</p>

Representatives' Comments	Task Force/IAASB Response
<p>stakeholders. He noted that ISQC 1¹ is fully scalable for smaller entities and using ISQC 1 to support audit quality in SMPs is important.</p>	
<p>Mr. Krantz asked how the audit quality framework would differ if prepared a decade ago.</p> <p>Mr. Kuramochi noted that the evolution of accounting standards over the last decade has also had an impact on auditing, including increasing the importance of professional skepticism.</p>	<p>Point taken into account.</p> <p>The Task Force believes that the fundamentals of audit quality have remained largely unchanged over time, namely the importance of audits being performed by competent auditors who exhibit appropriate values, ethics and attitudes; have sufficient time to perform their work and apply a rigorous audit process and quality control; provide valuable and timely outputs; and interact appropriately with stakeholders. Importantly, however, the Task Force believes that contextual factors have an influence on audit quality and their continuing evolution contribute to the complexity and dynamism of the topic.</p> <p>See paragraphs 18-20 of Agenda Item B.1.</p> <p>The Task Force agrees with Mr. Kuramochi that the evolution of the applicable financial reporting framework impacts the audit. In particular, the trend towards greater use of fair value measurements and other estimates has given rise to auditability or verifiability issues, and hence the need for greater exercise of professional judgment and skepticism by auditors. The Task Force has recognized this in the draft Framework. See paragraphs 206-211 of Agenda Item B.1.</p>
<p>Ms. Bastolla suggested the need for more emphasis on internal auditors, particularly regarding the work done on controls, risk, compliance and attainment of financial and other objectives. She also noted that the paper should mention the auditor's interactions with internal auditors, and internal auditors' interactions with those charged with governance.</p>	<p>Point accepted. The material on internal audit has been expanded (within the context of external audit quality rather than effective corporate governance) and the importance of interaction emphasized. The Task Force debated whether to deal with interactions between internal and external auditors in Section 5 but decided it was</p>

¹ 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*

Representatives' Comments	Task Force/IAASB Response
	<p>better to limit that section to participants in the financial reporting supply chain. This mirrors the treatment of other “internal” interactions such as with experts and component auditors.</p> <p>See paragraphs 112, 217 and 220 of Agenda Item B.1.</p>
<p>Mr. Cassel commented that a stronger emphasis on professional skepticism was needed. He noted that, while the paper is based on all stakeholders pursuing common goals, not all stakeholders have common goals all the times, which poses challenges to audit quality and increases the importance of professional skepticism.</p>	<p>Point accepted.</p> <p>See paragraphs 37-39, 172 and 227 of Agenda Item B.1.</p>
<p>Mr. Morris noted that the Task Force survey seemed to equate audit quality to audit efficiency, and that the paper needs to have a greater focus on audit quality.</p> <p>Mr. White agreed with Mr. Morris, noting that the core objectives of the paper seem to be to (i) minimize risk of audit failure and (ii) reduce errors in audit reporting. However, this was not clear.</p> <p>Mr. Johnson agreed with Mr. White, noting that investors are looking for assurance on the quality of financial reporting, rather than stopping all audit failures, of which there are few in practice.</p>	<p>Point taken into account.</p> <p>The Task Force agrees that the emphasis of the paper needs to be on audit effectiveness. However, the Task Force believes that, if the Framework is to be holistic, it also needs to deal with efficiency which is clearly important to management (as shown from the responses to the survey of stakeholder perspectives). The Task Force believes that there is a balance to be struck between maximizing the amount of audit evidence to be obtained and the cost of doing so. See paragraphs 13-15 of Agenda Item B.1.</p> <p>While the overwhelming majority of inputs relate to effectiveness, an attribute dealing with efficiency has been added to the Framework (Audit Process – engagement level). See paragraph 107 of Agenda Item B.1.</p> <p>The Task Force also believes it is important to recognize the threat to AQ of undue constraints on audit fees. See paragraphs 83 and 215 of Agenda Item B.1.</p>
<p>Mr. Hansen noted that the paper could define audit failures more clearly.</p>	<p>Point not accepted. The Task Force has focused on trying to define audit quality. In a broad sense, an audit failure is a failure to deliver audit quality.</p> <p>In a narrow sense, however, the term audit failure probably has a legal/regulatory meaning which will</p>

Representatives' Comments	Task Force/IAASB Response
	<p>vary from one country to another. The Task Force would welcome views on whether an area for possible action relates to exploring whether it might be useful to explore the benefits of international coordination in the area of enforcement and disciplinary action. See issue C below.</p>
<p>Mr. Johnson explained that the Fédération des Experts Comptables Européens (FEE) response to the European Commission (EC) Green Paper noted that inputs are good and useful, but the big issue is the desired goals, such as the three-way dialogue between management, the auditor and regulators.</p>	<p>Point noted.</p>
<p>Ms. de Beer suggested that the focus on audit quality could be made clearer at the start of the paper.</p>	<p>Point accepted – see Chairman's Foreword and revised introduction to the Consultation Draft.</p>
<p>Mr. Kuramochi noted that IOSCO supports the IAASB's focus on audit quality. He noted that a recent article in the Financial Times, titled "Auditors under fire over Greek debt," reported that auditors have not enforced a consistent approach across all their clients. Mr. Kuramochi added that he did not believe that this related to audit quality, but accepted that it may affect perceptions of audit quality. He noted that even within the same firm there are variances in approach, which may have implications for ISQC 1. He asked if, given the notion that an audit is an audit, it would be reasonable for the public to expect the same outcome if the same auditing and ethics standards have been applied to an audit.</p>	<p>Support noted.</p> <p>The Task Force is of the view that the <i>proper</i> application of auditing standards relies on the exercise of appropriate professional judgment, not least because auditing standards cannot anticipate and cater for all possible circumstances.</p> <p>Material has been added to the Framework on professional judgment. See paragraphs 75-76 of Agenda Item B.1.</p> <p>Also, the Task Force believes that what is considered "sufficient appropriate audit evidence" is, to a degree, a matter for judgment, reflecting the nature and complexity of the entity as well as the auditor's assessment of the risks that the financial statements could be materially misstated. The Task Force has made this clear in the draft Framework. See paragraphs 11-12 of Agenda Item B.1.</p> <p>Improving the consistency of judgment within firms and indeed across the profession is the sort of issue that could emerge from continuous improvement initiatives. The importance of these</p>

Representatives' Comments	Task Force/IAASB Response
	is recognized in the draft Framework. See paragraph 141 of Agenda Item B.1.
<p>Mr. Koktvedgaard expressed concern that the paper was too ambitious, lacked boundaries and continued to confuse audit quality with audit risk. He added that he believed that it should be possible to have a very high-quality audit at a client where internal controls are weak. He noted that the paper identified weak internal controls as a risk to audit quality, when it actually affects audit risk. He further added that other matters are relevant, including the environment, quality of the accounting standards and quality of an entity's governance. He noted that the audit profession asks users to trust the audit opinion, but this mechanism fails to distinguish between good audits and bad audits, as all result in an audit opinion. Mr. Hansen expressed the view that the paper was trying to cover too much, and should be restricted to matters within the control of the auditor.</p>	<p>Point taken into account.</p> <p>The Task Force agrees that the project is ambitious but, because it is trying to develop a holistic framework, it has not reduced its scope.</p> <p>Rather it has tried to address these concerns through emphasizing that auditors are responsible for the quality of individual audits (see Section 1.3 of Agenda Item B.1). In addition, the Task Force has restructured the Framework to focus on matters that auditors can control (see Issue A below).</p>
<p>Mr. Gutterman supported the paper's emphasis on culture. He noted that culture and relationships are the most significant factors affecting audit quality, such as the relationship between management and auditor and the auditor's willingness to challenge management. He suggested that the paper should give more emphasis to the need to engage experts when appropriate and further delineate the relationship with the various regulators involved, including audit regulators, capital market regulators and business regulators.</p>	<p>Support noted and point taken into account.</p> <p>The important role of experts and specialists is recognized in the draft Framework. See paragraphs 30, 58, 80 and 111 of Agenda Item B.1.</p> <p>A discussion on types of regulators has been provided in Section 5.4 of Agenda Item B.1.</p>
<p>Mr. Jusuf noted that deadlines have an impact on audit quality and asked how this was reflected in the paper. Mr. Grant explained that the paper has some discussion on the topic, particularly about not pressuring the auditor for information too quickly, although short deadlines are a response to market demands. He noted that the Task Force would consider whether more could be added on the topic.</p>	<p>Point accepted.</p> <p>See Section 6.6 of Agenda Item B.1. In addition, the importance of allowing adequate time for audit work has been recognized in input attributes at the engagement and firm levels.</p>
<p>Mr. Hansen did not support the application of a threats and safeguards approach and asked if this was the default position considered by the Task Force. He also asked if the goal was to establish minimum standards of audit quality.</p>	<p>Point taken into account.</p> <p>The Task Force has not further pursued a threats and safeguards approach to AQ.</p>

Representatives' Comments	Task Force/IAASB Response
<p>Mr. Johnson noted that auditor reporting overlaps with issues of audit quality, as he sees the concerns more on an information gap rather than an expectations gap. In his view, better information on the audit will improve investor perceptions.</p>	<p>Point accepted.</p> <p>The need to increase the informational value of audit reports has been recognized in the draft Framework. See paragraph 148 and related area for possible action in Agenda Item B.1.</p>
<p>Ms. Sucher noted that the definition of audit quality should be made more prominent in the paper. She suggested that there be greater coverage of the role of, and relations with, prudential regulators, and that paragraphs 31-32 of Agenda Item C-1 were overly focused on how regulators can assist auditors rather than presenting a more balanced perspective. She disagreed with paragraph 62, noting that there is more auditor judgment the higher the estimation uncertainty.</p>	<p>Point taken into account.</p> <p>The definition of audit quality is now in the draft Framework. See paragraph 18 of Agenda Item B.1.</p> <p>A discussion on types of regulators has been provided in Section 5.4 of Agenda Item B.1. The Task Force has endeavored to provide a more balanced discussion of the role of regulators (see Section 5 on interactions between regulators and auditors, management, audit committees and users in Agenda Item B.1).</p>
<p>Mr. Baumann agreed with the concerns expressed by others, and did not believe the paper was on target yet. He noted that the paper still did not deal with assessment or measurement of audit quality by audit committees. He also noted that the paper is more concerned with financial reporting quality. He agreed with Mr. Koltvedgaard that audit quality should be high regardless of the quality of governance or management, and also noted that regulators expect audits to be conducted in accordance with auditing standards. He expressed concern that the paper does a disservice to auditors by implying that audit quality will not be high if those other factors are not high-quality. In this regard, he highlighted that the wording of certain paragraphs was problematic, and made the following observations in relation to Agenda Item C-1, as examples thereof:</p> <ul style="list-style-type: none"> • Paragraph 21 – an effective audit can be done irrespective of whether there is cooperation by, or open dialogue with management, such as by expanding the scope of audit or using additional resources. • Paragraph 40 – auditors should perform high quality 	<p>Point taken into account.</p> <p>The Task Force has taken a number of actions to address this important concern and would welcome the CAG's views on whether these actions are sufficient (see Issue A below).</p> <p>The IAASB discussed the issue of the measurement of AQ when agreeing the project objectives and decided that the project would be descriptive in nature. This does not, however, preclude others from working on measurement; indeed, the existence of a descriptive framework could well be of assistance to them.</p>

Representatives' Comments	Task Force/IAASB Response
<p>audits irrespective of user involvement.</p> <ul style="list-style-type: none"> Paragraph 49 – the paper appears to allow auditors to point to overly complex related party transactions as an excuse for audit failures. Paragraph 62 – the paper gives the impression that there is too much judgment involved in applying requirements of the financial reporting framework, and therefore it is difficult to do a high-quality audit, whereas he believes that auditors should be able to perform high-quality audits regardless of the complexity of the financial reporting framework. 	
<p>Mr. Roussey agreed that high-quality audits can be performed in adverse circumstances, and noted that other factors help auditors perform better audits. He recommended that the paper explain how these factors help the financial reporting process and help auditors perform better audits, such as pointing out that it is easier to perform a good audit in better environment than in a bad one. Mr. Roussey agreed with Mr. Baumann's comment about financial reporting quality.</p>	<p>Point accepted.</p> <p>The relationship between the quality of individual audits and AQ more generally is explored in paragraphs 18 and 19 of Agenda Item B.1. The link between efficiency and the contextual factors is noted in paragraph 198 of Agenda Item B.1.</p>
<p>Mr. Baumann expressed the view that the practice of auditing should be able to accomplish its objectives and that the paper mixes individual engagements and broader perspectives. Mr. Baumann also disagreed with paragraph 6 regarding the comment that audit quality cannot be accurately measured.</p>	<p>Point taken into account.</p> <p>See response to Mr. Baumann's comment above.</p>
<p>Mr. James asked if the survey of stakeholder perceptions had guided respondents towards a particular view of audit quality rather than taking the approach of a broader, more open survey that seeks views on audit quality. He asked if a roundtable would help to obtain additional perspectives.</p>	<p>The Task Force did not intend the survey to provide definitive views of audit quality. Rather, it was intended to inform the Task Force's consideration of the likely key attributes of audit quality.</p>
<p>Mr. Pannier noted that the paper was too lengthy, and needed to be better organized to give a sense of relative priority. He supported including a section dealing with matters within the control of the auditor first, then other matters, and that the survey elements should be integrated into each section.</p>	<p>Point taken into account.</p> <p>See Issue F, below in relation to packaging. See also the table in paragraph 8 of Appendix 1 of Agenda Item B.1 linking the factors considered by stakeholders in the survey on perspectives to the Framework.</p>

Representatives' Comments	Task Force/IAASB Response
	In addition, as noted above, the Task Force has refocused the Framework on factors auditors can control.
Mr. Waldron noted that relationships and auditor rotation may also form part of audit quality.	Point accepted. Relationships covered in Section 5 on interactions, and rotation referred to in paragraphs 47, 57 and 89 of Agenda Item B.1.
Mr. Roussey expressed the view that the paper would benefit from a greater focus on professionalism, as he would like to see auditing go back to being a profession rather than competitive business. He noted that the paper could assist this by covering the auditor's responsibilities in the financial reporting process, such as the need to perform the audit in the public interest and how the auditor adds to the credibility of financial reporting. He also asked if the paper could cover the issue of moving the audit from being viewed as a commodity for which the focus is on obtaining the lowest price. Mr. Roussey recommended that the paper cover the challenges caused by overly principles-based and overly rules-based accounting frameworks. He noted that the U.S. went to rules-based accounting to give auditors rules to follow and enforce with clients, instead of having difficult discussions over principles. He suggested the major international firms should be asked to adopt the audit quality framework in some way.	Point accepted. The Task Force agrees with the comments about professionalism and a focus on the public interest as this is what the development of the Framework is aiming to achieve. The Framework emphasizes values, ethics and attitudes and has an attribute dealing with auditors recognizing the wider public interest. See paragraph 36 of Agenda Item B.1. The draft Framework recognizes the challenges of overly principles-based and overly rules-based financial reporting frameworks. See paragraph 207 of Agenda Item B.1. The Consultation Draft also includes as an area of possible action that firms develop a common understanding of AQ for use when evaluating, promoting and remunerating partners and staff (see Chairman's Foreword in Agenda Item B.1).
Mr. Hallqvist expressed the view that there are cost limitations in audits, and that auditing firms should decline work if the fees are too low, or time is too limited, in order to ensure audit quality. He noted that some companies are very greedy about fees and firms should decline rather than accept such engagements.	Point taken into account. See responses above regarding the importance of avoiding undue constraints on audit fees and of providing adequate time for the performance of the audit work.

Matters for CAG Consideration

14. The Representatives are asked to note the Report Back above, in particular the improvements to the Framework made as a result of the CAG's comments. In addition, the Representatives are asked to consider the following matters.

A. Proposed Reorganization of Framework

15. The most important single issue that arose from the outreach phase was the perception that the Framework did not focus sufficiently on factors that auditors can control. In particular, a significant CAG comment had been that the CAG Draft (i.e., the draft Framework considered by the CAG in September 2011) had often sounded defensive and that some of the words or examples used sounded like excuses for auditors.
16. In response to this input, the Task Force has made a number of structural and editorial changes to the draft Framework, including the following:
 - Reorganizing the chapters to give greater emphasis to the inputs in order to emphasize those aspects of AQ that the auditor can control.
 - Within the chapter on inputs, reorganizing the attributes material into three separate sections, i.e., at the engagement, firm and national level in that order.
 - Placing the discussion of key interactions between participants in the financial reporting supply chain before the discussion of contextual factors. This recognizes that the interactions are closer to the audit engagement level and have a direct link with outputs.
 - Moving the discussion of stakeholder perspectives to an appendix to the consultation draft, as these are not part of the Framework as such. The Task Force thinks the appendix will assist in obtaining views on the consultation draft but would likely not be part of the final Framework.
 - Softening references to contextual factors directly influencing AQ.
 - Adding material in Section 1.3 to more clearly bring out the distinction between AQ and a high quality audit.

Matters for CAG Consideration

1. Does the CAG support the action taken to address the perception that the previous version did not focus sufficiently on factors that auditors can control? Is the draft Framework successful in illustrating the contribution that other stakeholders can make to improving AQ without appearing to dilute the responsibilities of auditors themselves?

B. Introduction

17. Given input received from a number of groups that commented on the CAG Draft, the Task Force concluded that the draft did not sufficiently explain the complexities associated with AQ. The Task Force had therefore proposed adding material to the introduction to the AQ Framework paper to describe some of the characteristics of audit that make evaluating AQ difficult. An early draft of such material was discussed at the December 2011 IAASB meeting. While the value of material of this nature was recognized, there was some concern at the IAASB that the proposed material may appear defensive.
18. In response, the Task Force has revised the material in the introduction to be more neutral in tone.

Matter for CAG Consideration

2. Are the complexities of an audit sufficiently explained in the draft without it sounding defensive?

C. Areas to Explore Where Actions Could be Taken to Enhance Audit Quality

19. In developing the Framework, the Task Force has identified a number of areas to explore where potential action by auditors and other stakeholders may benefit overall audit quality. Although these areas are not part of the Framework, the Task Force has highlighted them at various points in the Framework and listed them in the Chairman's Foreword with a view to stimulating international debate about whether action would be appropriate.
20. The consultation draft does not include any areas for exploration in relation to audit regulators. However, some members of the Task Force believe that audit regulators could do more to promote AQ through, for example:
- Sharing with stakeholders a balanced view on AQ, including the strengths that have been identified;
 - Sharing with audit committees key findings from inspections to assist in enhancing the effectiveness of audit committees' interactions with auditors;
 - Helping the profession understand how best to address weaknesses identified and communicating views on effective audit practices, including the need for greater consistency in such practices amongst firms;
 - Helping audit firms, particularly smaller practices, understand and implement auditing standards; and
 - Analyzing the effectiveness of auditing standards in the light of the findings from audit inspections.
21. The Task Force recognizes that some national audit regulators have been able to make progress in some of these areas and hopes that these and other good practices can be applied with greater consistency internationally.
22. The Task Force also believes that there is likely to be value in greater international coordination of those aspects of audit regulation dealing with disciplinary matters (see paragraph 140 of the draft Framework).
23. The Task Force hopes that these topics will be further discussed with the International Forum of Independent Audit Regulators (IFIAR) at its annual meeting in October 2012.

Matters for CAG Consideration

3. Are the areas for exploration that have been identified an appropriate output from this project? Are there others? In particular, might it be useful to explore the benefits of international co-ordination of action in the area of enforcement and disciplinary action?

D. Contextual Factors

24. The Contextual Factors section of the Framework has been one of the most challenging for the Task Force. These factors impact the quality of financial reporting and corporate governance as well as, indirectly, audit quality. The material in the draft Framework has been prepared drawing upon the experience of the Task Force members as well as from a number of papers but this topic does not seem to have been fully explored before.
25. In response to input received during the outreach phase, the Task Force had proposed that the AQ Framework paper elaborate on the impact on audit quality of the requirements of the applicable financial reporting framework from an “auditability/verifiability” perspective.

Matters for CAG Consideration

4. Does the CAG have any suggestions as to how the Contextual Factors section of the draft Framework can be further improved?

E. Completeness

26. The Task Force has endeavored to develop as comprehensive a Framework as possible, recognizing the need to adequately capture its holistic nature. The Task Force believes that the input it has received from various stakeholders during the outreach phase has been very helpful in this regard. Nevertheless, the Task Force acknowledges that further discussion with the CAG, the IAASB and consultation with stakeholders may help further improve the Framework.

Matter for CAG Consideration

5. Are there other attributes or other aspects of AQ not in the draft Framework that should be included?

F. Summarization and Packaging

27. The Framework draft is relatively lengthy at 55 pages (excluding appendices). The IAASB is conscious of the need for the Framework to be as concise as possible and made usable by different stakeholder groups. The importance of this has been reinforced by a number of commentators during the outreach phase, including Representatives of the CAG.
28. The Task Force has debated this topic and has three suggestions that could be applied individually or in combination:
- The Framework has been summarized in Section 2.
 - Checklists have been developed for two possible user groups – audit firms (Appendix 2) and audit committees (Appendix 3). The checklists illustrate how relevant attributes in the Framework can be used to help those stakeholders explore whether they need to do more to assist audit quality. Other checklists could be developed, for example, at the national level.
 - Developing abridged versions for individual user groups. Doing so could help its flexibility and practical application, and communicate its broad appeal to a varied audience. If there was support for this approach, separate papers drawing from the IAASB Framework could be

developed for different stakeholders, either by IAASB or probably better by other international groups themselves, possibly in collaboration with the IAASB. **Agenda B.2** provides an illustration of how this can be achieved for audit committees. (The content of **Agenda B.2** is not intended for debate by the CAG).

29. Different views exist in the Task Force about the idea of abridged versions for different stakeholders. While some see benefit in the IAASB actively working with different stakeholders, others are concerned about the maintenance challenge this might cause. Also while shorter versions could contain material of more direct relevance to the stakeholder groups at which they are aimed, there is a danger that they might not retain sufficient context to convey the IAASB's views about the holistic nature of AQ and its complexity.

Matters for CAG Consideration

6. What are the CAG's reactions to the Task Force's ideas on how best to package the Framework so that it is of practical benefit to, and has maximum impact for, stakeholders (the CAG is not asked to comment on the *content* of **Agenda Item B.2** but only on the principle)? Are there other suggestions?

Material Presented – IAASB CAG PAPERS

Agenda Item B.1	Consultation Draft – Version 1, <i>Audit Quality: An International Framework</i> (Dated August 2012)
Agenda Item B.2	Abridged Draft – <i>An Audit Quality Framework for Use by Audit Committees</i> (Dated August 2012)

Appendix 1

Main Comments Received from Stakeholders During the Outreach Phase

Purpose / Value / Structure

#	Main Comments	Source	Proposed Action(s)
1.	Gives impression that auditors are not primarily responsible for AQ. Need to make clear that a high quality audit can be performed in adverse circumstances – it's a matter of efficiency. "Focus on what auditors can control."	CAG, IOSCO	Restructured the Framework to: <ul style="list-style-type: none"> • Include an "audit engagement level." • Start with the inputs section i.e., those matters that the auditors can influence the most.
2.	Uncertainty about whether the AQ Framework paper (and hence the schematic) is the best way of describing AQ. Suggestions: <ul style="list-style-type: none"> • Delink AQ from financial reporting quality. • Have 3 levels (audit engagement, firm, country). Possible to show AQ as an umbrella with profession, academia, firms and audit teams as the spokes.	Academics INTOSAI	<ul style="list-style-type: none"> • Restructured the Framework to split inputs among engagement, firm and national levels. Outputs focused on engagement level. Interactions and context not split. • Focused Contextual Factors on broader financial reporting issues. Moved material on audit inspection to inputs.
3.	Why isn't there a definition of AQ? IASB define the characteristics in their Statement of Principles – can a similar approach be followed?	WB, IOSCO	Description of AQ and contrast with quality of an audit engagement added in Section 1.3. ²
4.	Give more emphasis to audit effectiveness (as opposed to audit efficiency).	CAG	<ul style="list-style-type: none"> • Effectiveness emphasized throughout. However, some links to efficiency needed if we are to keep the Framework "holistic." • Specific references to efficiency considerations, e.g., in paragraph 113, not

² Unless otherwise stated, references to sections, paragraphs, etc are to the Consultation Draft in **Agenda Item B.1.**

#	Main Comments	Source	Proposed Action(s)
			considered excessive. <ul style="list-style-type: none"> Links between interactions and context softened.
5.	Paper rather conceptual – need to add appendices demonstrating how the Framework can be applied in practice. Suggestion to reorganize Threats and Safeguards as “key issues” for each of the main stakeholders. Begs the question “so what?” Need for the paper to trigger stakeholder actions.	Canadian stakeholders Academics INTOSAI	See Appendices 2 and 3 in the Consultation Draft – Version 1.
6.	Need to emphasize the importance of the linkages between the AQ elements. Without this there is a danger that too much emphasis will be placed on the context.	Canadian stakeholders	Links described in AQ Framework section of the Introduction.
7.	Length of paper / packaging – will it make a difference?	CAG, ICGN, UK academics	See Issue F.

Additional Elements to AQ Framework

#	Main Comments	Source	Proposed Action(s)
1.	Need to encourage the profession to be more receptive to self-examination/value of research in continuous improvement.	Academics	Added area for potential action in Chairman’s Foreword.
2.	Whether more is needed on the auditability of GAAP.	Academics	Section in context expanded. Discussed with IAASB in December 2011.
3.	Add more on role of internal auditors. Not sure internal audit contribute much to AQ – remit usually different.	CAG WB	Already in inputs (paragraph 112). New paragraph 217 added to Context – corporate governance, plus question in Appendix 3 on interaction between internal and external audit.

#	Main Comments	Source	Proposed Action(s)
4.	Add more on role of experts.	CAG, Canadian stakeholders, IESBA	Material added to Inputs – Knowledge and Experience – engagement level (paragraph 80).
5.	More emphasis needed on professional judgment and skepticism? Professional judgment is the “elephant in the room.”	CAG, SMP Committee	<ul style="list-style-type: none"> References in “Nature of an Audit” section of the Introduction (paragraph 4). Material in paragraphs 37-39 expanded.
6.	Culture within a firm critical <ul style="list-style-type: none"> No good just having technical resources – culture must be that they are used. Need to deal with remuneration of partners. Needs to reflect AQ not marketing. Is it realistic that economic goals should not jeopardize AQ? 	IOSCO	Revised material on inputs to give this appropriate emphasis. <ul style="list-style-type: none"> Emphasis on importance of consultation Partner remuneration referred to in paragraph 52. Bullet points in paragraph 55 to flag financial considerations.
7.	Vocal investors can drive AQ.	IOSCO	Addressed via interactions with users.
8.	How thoroughly do the firms and the profession explore failures and act to remedy systemic failures? Other professions more rigorous, e.g., doctors, air traffic controllers.	FOF	See item 1 immediately above.
9.	Should audit staff have broader business experience?	FOF	Additional material on general business knowledge included in paragraphs 73-74.
10.	Need a better explanation of how auditing standards contribute to AQ.	Canadian stakeholders	<ul style="list-style-type: none"> Added material in introduction (paragraph 3). Strong linkage with Audit Process attributes (at all levels).

Insights into the Nature of AQ

#	Main Comments	Source	Proposed Action(s)
1.	Can the same high quality audit be undertaken irrespective of the context? Is AQ a relative or an absolute concept?	FOF	Interactions between inputs, outputs, interactions and context described in introduction.
2.	Further, regulators seem to be expecting “zero failure” – this also seems to be the position with litigation. Is this reasonable?	FOF	No action taken. More of an issue for audit regulators.
3.	Audit has been “industrialized” in recent years. This has probably been beneficial, but has it reached a “tipping point?”	FOF	Material in revised draft reconsidered to ensure appropriate emphasis on the “thinking” audit and the need for senior engagement team members to be active on the field.
4.	Are senior management sufficiently engaged in the audit? Would changes in audit reports encourage greater involvement?	FOF	Importance of auditor-management interaction emphasized. Changes in audit reports may encourage greater management involvement – to be considered under IAASB’s Auditor Reporting project.
5.	Audits rejected by one firm’s client acceptance systems are accepted by another’s. Is there sufficient communication of information within the profession? Would AQ or perceptions of AQ be better if some entities were unable to obtain an auditor?	FOF, IOSCO	Paragraph 69 on information sharing + possible area to explore in Chairman’s Introduction.
6.	Needs fuller discussion of the link between AQ and audit fees. More emphasis on tension that exists between management wanting to minimize cost and investors wanting AQ. Fees may warrant greater coverage.	SMPC ICGN IESBA	Added material in paragraphs 15, 83, 176 and 215.

#	Main Comments	Source	Proposed Action(s)
7.	Is competition reducing audit fees to the detriment of AQ?	FOF	Relationship between AQ and fees discussed in the Framework – see paragraphs 83 and 215.
8.	If a fuller disclosure of work done was given in audit reports, would this transparency lead to better differentiation amongst firms, greater competition over AQ, and in turn higher audit fees?	FOF	Added material in paragraph 148.
9.	Better not to use the term culture as many other factors such as business practices. May be other useful information in paper by Nobes and Parker.	UK academics	<ul style="list-style-type: none"> • Term “Broader cultural Factors” used • Reference to academic studies on the impact of culture on accounting and auditing activities noted in paragraph 224.

Others

#	Main Comments	Source	Proposed Action(s)
1.	Need to deal with role of audit committee in appointing auditors.	Canadian stakeholders	Added material in paragraph 215.
2.	Need to consider how best to present independence – more than just independence from management.	IESBA	Reorganized Input factors to better reflect Ethical Fundamental Principles.
3.	Debate benefits of two tier boards vs. unitary board structure?	CAG	Not the role of this paper.
4.	Make clear that the role of audit is to minimize the likelihood that there are misstatements in the financial statements. Clarify what an audit failure is.	CAG	Addressed by general changes to structure and wording in Introduction.
5.	Danger of mixing AQ and audit risk.	CAG	The Framework distinguishes between AQ and the quality of an audit.

#	Main Comments	Source	Proposed Action(s)
6.	Need to allow for 3 categories of regulators.	CAG	See paragraph 180.
7.	Need to address rotation.	CAG, WB	Long association threat in paragraph 47.
8.	A major problem exists in smaller countries with certifying / licensing audit firms and dealing with complaints.	WB	Material added – paragraph 97.
9.	Helpful to emphasize the role of audit committees in directing internal audit and overseeing external audit. They bring things together.	WB	Paragraph 217 and Question in Appendix 3 on interaction between internal and external audit.
10.	Is there a need to define SMP / SME?	WB	The Framework will be a thought piece and will not impose requirements, hence definition not needed.
11.	Needs more emphasis on global reach of the Big Four.	Academics	Section 7 on group audits has some related material.
12.	More information needed on how survey of Stakeholder Perspectives was conducted, i.e., process followed.	UK academics	Appendix 1, paragraphs 4, 5 and 6.

Appendix 2

Project History

Project: Audit Quality

Summary

	CAG Meeting	IAASB Meeting
Project commencement	September 2010	December 2009 June 2010 December 2010
Issues Paper and IAASB Working Group Proposals	March 2011	March 2011
Development of Proposed Consultation Paper	September 2011 September 2012	June 2011 September 2011 December 2011 September 2012

CAG Discussions: Detailed References

Project Commencement	<p><u>September 2010</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/5665.pdf</p> <p>See CAG meeting minutes (in Agenda Item P of the following): http://www.ifac.org/sites/default/files/meetings/files/6186.pdf</p> <p>See report back on September 2010 CAG meeting (in paragraph 7 of the following): http://www.ifac.org/sites/default/files/meetings/files/6085.pdf</p>
Issues Paper and IAASB Working Group Proposals	<p><u>March 2011</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/6085_0.pdf</p> <p>See CAG meeting minutes (in Agenda Item F of the following): http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemA-Final_March_2011_Public_Minutes_APPROVED-v1-03.pdf</p> <p>See report back on March 2011 CAG meeting (in paragraph 8 of the following): http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemC-Audit-Quality-v1-02.pdf</p>

Development of Proposed Consultation Paper	<p><u>September 2011</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemC-Audit-Quality-v1-02.pdf</p> <p>See CAG meeting minutes (in Agenda Item C of the following): http://www.ifac.org/sites/default/files/meetings/files/20120306-IAASBCAG-Agenda_Item_A-Draft_September_2011_Public_Minutes-Marked-v3.pdf</p> <p>See report back on September 2011 CAG meeting in Paragraph 13 of this CAG paper.</p>
---	---