

Audit Quality—Matters for Consideration**A. Background***June 2011 IAASB Discussion*

1. At the June 2011 meeting, the IAASB considered a first draft of the Audit Quality Framework (“Framework”) paper. The IAASB expressed strong support for a holistic approach to the development of the proposed Framework. Amongst other matters, suggestions were made for the paper to give greater recognition to the dynamism of audit quality (AQ), to recognize the influences of technology and industry circumstances as important additional contextual factors, to further consider the linkages with efficiency and cost, and to reconsider the AQ schematic so that it more effectively articulates the various elements of the Framework and the Framework’s dynamism.
2. On the basis of this input and as agreed by the IAASB, the Task Force developed a revised draft of the Framework paper (the “CAG Draft” – see **Agenda Item 6-F**) for purposes of soliciting initial reactions and input from specific stakeholder groups in Q3-Q4 2011.
3. Key highlights of the discussions with stakeholders on the CAG Draft are set out below.

August 2011 Focus Group Meeting with Academics

4. As briefly reported by the Task Force Chair at the September 2011 IAASB meeting, representatives of the Task Force met six very experienced academics (four from the U.S., one from Australia, and one from Canada) in Denver on August 7th to discuss the CAG draft. The meeting was arranged by Board member Bill Kinney, who was one of the participants. The academics seemed genuinely interested in the project and made a number of constructive suggestions as to how the Framework might be improved. A number said they struggled with understanding the current model. An alternative structure was suggested which is more consistent with the way the topic has been treated in a number of recent studies.¹

September 2011 IAASB CAG Meeting

5. Some CAG representatives welcomed the project and were broadly supportive of the CAG draft, with some commenting that it was well balanced and thoughtful.
6. One CAG representative, however, took a different position and criticized the paper for dealing with systemic issues rather than focusing on audit quality at the engagement level. A number of other CAG representatives agreed that poor contextual factors such as weak corporate governance cannot be used as an excuse for a poor quality audit. Several thought that the Framework should focus more on factors that auditors can control.

¹ For example: *A Framework for Understanding and Researching Audit Quality* by Jere Francis, *Auditing: A Journal of Practice and Theory*, May 2011

7. Some CAG representatives expressed concern that too much emphasis was placed on efficiency in the proposed Framework and were of the view that more of that emphasis should be placed on effectiveness.

October 2011 Forum of Firms' Audit Quality Symposium

8. There was constructive discussion on the topic of AQ at the Forum of Firms' symposium in New York on October 5th. The Chair of the Task Force gave an overview of, and an update on, the project. He also participated in one of the two panel sessions.
9. Overall, there was considerable support for, and interest in, the project. Some participants noted the usefulness of having a framework to facilitate discussions on AQ amongst stakeholders. Others observed that the IAASB's outreach to stakeholders in this project had already been valuable in stimulating debate on the topic.
10. The draft Framework was not challenged in the Symposium but a number of observations made which added valuable perspective to the complexities of AQ.

Other Stakeholder Outreach

11. The draft Framework has been circulated to a number of other stakeholders, including the following:
 - International Forum of Independent Audit Regulators (IFIAR)
 - International Corporate Governance Network (ICGN)
 - World Bank
 - Canadian stakeholders
 - International Ethics Standards Board for Accountants (IESBA)
 - International Accounting Education Standards Board (IAESB)
 - IFAC Small and Medium Practices (SMP) Committee
 - International Organization of Supreme Audit Institutions (INTOSAI)
 - International Organization of Securities Commissions (IOSCO)
12. The depth to which the stakeholders considered the Framework varied as has the nature of the comments received. The main issues raised by the representatives of those groups and organizations, though not necessarily the consensus of the groups or organizations they represent, are summarized in the Appendix to this paper. The main issues for IAASB consideration at this stage are set out below.

B. Matters for IAASB Consideration

AN ALTERNATIVE FRAMEWORK STRUCTURE

13. The Framework is currently structured based on the key elements of input, interactions, outputs and context. A number of respondents find this, and the diagram in paragraph 10 of the CAG Draft, to be confusing. The academics and an INTOSAI representative have

suggested that the structure should distinguish AQ at the audit engagement, firm and country levels.

14. The Task Force overall believes that this suggestion for an alternative structure has merit and should be pursued, although a concern was raised within the Task Force that the further detail may make the structure appear more complex. The Task Force proposes that, within each of the audit engagement, firm and country levels, the material be structured by inputs, interactions, and outputs. Context (split between that directly applying to audit at the national level and that applying more directly to financial reporting quality) would be kept as separate elements (see **Agenda Item 6-C**).
15. Advantages of this approach are that:
 - (a) It would focus the Framework on what auditors can influence.
 - (b) It would help make it easier for stakeholders to use the Framework (especially management and audit committees).
 - (c) It reflects a number of academic studies.
16. The main disadvantage is that it might be thought that the Framework, by and of itself, will be sufficient to assess the quality of an individual audit.
17. The Task Force believes that adopting this alternative approach for presenting the Framework will require significant restructuring of the CAG draft. As an illustration of how the paper would be redrafted to deal with the Engagement Level considerations using this alternative structure, the Task Force has put together the Engagement Level section shown in **Agenda Item 6-B** based on the content of the CAG draft.

Matters for IAASB Consideration

1. Does the IAASB agree with the Task Force's proposal regarding structuring and presenting the Framework along the lines described above?
2. Does the illustrative Engagement Level section shown in **Agenda Item 6-B** represent an appropriate way to describe the key AQ attributes applicable at that level?

SUMMARIZATION

18. The CAG draft is relatively long at 52 pages. The IAASB has already discussed the need for the Framework to be more concise. The importance of this has been reinforced by a number of commentators.
19. The Task Force has discussed an approach that would mirror the ISAs – i.e., separating the key points from the descriptive explanatory material – and has developed a summary of key attributes of AQ shown in **Agenda Item 6-C**.

Matter for IAASB Consideration

3. Does the IAASB agree with the Task Force's proposal regarding summarizing the Framework along the lines described above?

INTRODUCTION

20. In the light of the input received at the Forum of Firms’ symposium and feedback from the CAG discussion, the Task Force believes that the CAG draft does not sufficiently explain the complexities associated with AQ. The Task Force believes that further elaboration of this particular issue would be important to ensure that stakeholders do not harbor unrealistic expectations about whether the Framework can be used as, or provides for, a measurement tool (see **Agenda Item 6-D**).
21. While it is hoped that the Framework will provide a platform for stakeholders to understand AQ and take further appropriate actions to enhance it, the Task Force believes that it is *not* an objective of this project to design a framework for the measurement of AQ at an individual engagement level.

Matter for IAASB Consideration

4. What are the IAASB’s views regarding the Task Force’s proposed messages in the expanded introductory part of the Framework paper (**Agenda Item 6-D**)? Is it sufficiently clear that the Framework is not designed to assess the quality of an individual audit?

IMPACT OF THE REQUIREMENTS OF THE APPLICABLE FINANCIAL REPORTING FRAMEWORK

22. On a separate matter, and in response to input received, the Task Force believes that it would be appropriate for the Framework paper to elaborate on the impact on AQ of the requirements of the applicable financial reporting framework from an “auditability/verifiability” perspective. In this regard, the Task Force has drafted the text shown in **Agenda Item 6-E** based on some of the auditability considerations included in the IAASB’s recent discussion paper on disclosures² as well as some of the IAASB’s comment letters on recent exposure drafts of the International Accounting Standards Board (IASB).

Matter for IAASB Consideration

5. What are the IAASB’s views regarding the Task Force’s proposed additional comment on the impact of the requirements of the applicable financial reporting framework on AQ?

NEXT STEPS

23. Informed by the IAASB’s comments, the Task Force will restructure the CAG Draft as appropriate and respond to the other comments received. The Task Force plans to have another draft available to the IAASB for discussion at the March 2012 meeting.

Matter for IAASB Consideration

6. With regard to the other stakeholder comments included in the Appendix, does the IAASB have any views or comments that the Task Force should consider in developing the next draft of the Framework paper?

² January 2011 Discussion Paper, *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications*

APPENDIX

Main Issues Arising from “Reach-Out” Phase

Purpose / Value / Structure

#	Main Comments	Source	Proposed Action(s)
1.	Length of paper / packaging – will it make a difference?	CAG, ICGN	Issue recognized by IAASB. The TF has two suggested solutions: a) Developing a summary Framework (Issue 3 to be discussed by IAASB.) b) Focusing the Threats and Safeguards summary on key stakeholders.
2.	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. “Focus on what auditors can control.”	CAG, IOSCO	Most members of the TF agree that restructuring the Framework to include an “audit engagement level” will assist. (Issues 1 and 2 to be discussed by IAASB.)
3.	Uncertainty about whether the framework paper (and hence the schematic) is the best way of describing AQ. Suggestions: • Delink AQ from financial reporting quality • Have 3 levels (audit engagement, firm, country)	Academics	(Issues 1 and 2 to be discussed by IAASB.)
4.	Possible to show AQ as an umbrella with profession, academia, firms and audit teams as the spokes.	INTOSAI	(Issues 1 and 2 to be discussed by IAASB.)
5.	Give more emphasis to audit effectiveness (as opposed to audit efficiency).	CAG	TF to review the balance. Efficiency needed if we are to keep the Framework “holistic.”
6.	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.	Canadian stakeholders Academics IOSCO	TF to explore focusing the Threats and Safeguards summary on key stakeholders.

#	Main Comments	Source	Proposed Action(s)
	Begs the question “so what?” Need for the paper to trigger stakeholder actions.	INTOSAI	
7.	Need to be careful how this is positioned. Especially the link between engagement level and systematic factors and context.	INTOSAI	Introduction rewritten. (Issue 4 to be discussed by IAASB.)
8.	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	TF to consider. This may be made easier by changing the Framework structure so as to have 3 levels.

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	TF to consider.
2.	Whether more is needed on the auditability of GAAP	Academics	(Issue 5 to be discussed by IAASB.)
3.	Whether there is a need to deal with AQ over time.	Academics	TF to consider.
4.	Add more on role of internal auditors.	CAG	TF to consider.
5.	Add more on role of experts.	CAG, Canadian stakeholders, IESBA	TF to consider.
6.	More emphasis needed on professional judgment and skepticism? Professional judgment is the “elephant in the room.”	CAG, SMP Committee	Addition to Introduction. (Issue 4 to be discussed by IAASB.)
7.	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	Added to Framework. TF to discuss associated explanatory guidance.
8.	Should audit staff have broader business experience?	FOF	TF to consider.
9.	Need a better explanation of how auditing	Canadian	TF to consider. This will be

#	Main Comments	Source	Proposed Action(s)
	standards contribute to audit quality.	stakeholders	made easier by changing the Framework structure so as to have 3 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	Addition to Introduction.
2.	Further, regulators seem to be expecting “zero failure” – this also seems to be the position with litigation. Is this reasonable?	FOF	Addition to Introduction.
3.	Audit has been “industrialized” in recent years. This has probably been beneficial, but has it reached a “tipping point?”	FOF	TF to consider.
4.	Are senior management sufficiently engaged in the audit? Would changes in audit reports encourage greater involvement?	FOF	TF to consider.
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	TF to consider.
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.	SMPC ICGN	Material added to introduction. (Issue 4 to be discussed by IAASB.)
7.	Is competition reducing audit fees to the detriment of AQ? 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	TF to consider.

Others

#	Main Comments	Source	Proposed Action(s)
1.	Need to deal with role of audit committee in appointing auditors.	Canadian stakeholders	TF to consider.
2.	Need to consider how best to present independence – more than just independence from management.	IESBA	TF to consider.
3.	Fees may warrant greater coverage	IESBA IOSCO	Addition to Introduction.
4.	Need to define the term “auditor”	IAESB	TF to consider.
5.	Culture within the firm is very important	IOSCO	TF to consider.