

Meeting: IAASB Consultative Advisory Group
Meeting Location: New York
Meeting Date: April 8-9, 2013

Agenda Item

C

Audit Quality

Objectives of Agenda Item

1. The objectives of this Agenda Item are:
 - (a) To obtain the Representatives' views on key questions posed in the IAASB's January 2013 Consultation Paper, *A Framework for Audit Quality*.
 - (b) To provide a report back to the Representatives on their comments at the September 2012 CAG meeting on the IAASB's draft Audit Quality Framework.

Papers to Be Referred to during Discussion

2. The discussion on this topic will follow the structure of this CAG Paper. The IAASB's January 2013 Consultation Paper, *A Framework for Audit Quality*, is included in Agenda Item C.1 as an IAASB CAG Paper.

Matters for CAG Consideration

3. In the 'Request for Comments' section of the IAASB Consultation Paper, *A Framework for Audit Quality*, the IAASB is seeking views on four key questions. These questions are reproduced below.
4. Although the proposed AQ Framework is out for exposure until May 15, 2013, the Task Force would find it helpful to hear the Representatives' initial views on these questions. It also believes that discussion with the Representatives, and between the Representatives, will help inform individual CAG Member Organizations (MOs) about differing perspectives on AQ that they may take into account when developing their written submissions on the IAASB AQ Framework Consultation Paper.

Matters for CAG Consideration

1. Representatives are asked for their initial or preliminary views on the following key questions posed in the IAASB AQ Framework Consultation Paper:
 - (a) Does the Framework cover all of the areas of audit quality that you would expect? If not, what else should be included?
 - (b) Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged

<p>with governance), and other stakeholders? If not, which areas of the Framework should be revised and how?</p> <p>(c) How do you intend to use the Framework? Are there changes that need to be made to the form or content of the Framework to maximize its value to you?</p> <p>(d) What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?</p>
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Project Status and Timeline

5. The draft Audit Quality (AQ) Framework was last discussed by the CAG in September 2012. The IAASB issued its Consultation Paper in January 2013. The deadline for comments on the Consultation Paper is May 15, 2013.
6. The Appendix to this paper provides a project history, including links to the relevant CAG documentation.

September 2012 CAG Discussion

7. Below are extracts from the draft minutes of the September 2012 CAG meeting,¹ and an indication of how the project Task Force or IAASB has responded to the Representatives' comments.

Representatives' Comments	Task Force/IAASB Response
OVERALL COMMENTS ON THE TONE AND BALANCE OF THE DOCUMENT	
Mr. Peyret noted that the CAG Working Group was generally supportive of the revisions made to the document.	Support noted.
Mr. Kuramochi noted that he hoped that the AQ Framework would contribute to raising quality of audits globally.	Support noted. This view is consistent with IAASB's vision for the Framework. (See page 8 of Agenda Item C.1)
Messrs. Baumann, James, Johnson, Morris and Pannier and Ms. Lang agreed that the overall tone of the document is now more balanced. Mr. Baumann supported the change in tone, noting that the revised document was more appropriately focused on what AQ is, rather than the influence of contextual factors. Mr. Morris agreed, adding that the revised document better explains what AQ is	Support noted.

¹ The minutes will be approved at the April 2013 IAASB CAG meeting.

Representatives' Comments	Task Force/IAASB Response
about and no longer overly emphasizes audit efficiency.	
Mr. James expressed the view that the factors influencing AQ are still overly tilted towards describing the responsibilities of other stakeholders rather than those that are the responsibility of auditors.	Point not accepted. The IAASB found the proposed Framework to be appropriately balanced. It was noted that the majority of the revised document is devoted to a discussion of the inputs to audit quality (approx. 30 pages), particularly at the engagement and firm levels which relate directly to auditors and firms.
Mr. Johnson questioned whether certain parts of the document, such as the introduction describing the challenges of defining AQ, were still defensive. He suggested moving these paragraphs towards the back of the document, perhaps in an Appendix. Mr. Pannier did not support Mr. Johnson's suggestion, noting that it was important to describe challenges to defining AQ.	Point partly accepted. The IAASB concluded that introductory material should be retained in its current location in the document as it provides essential context and much of the rationale for the need for the Framework. However, the IAASB agreed to revise the Foreword and Section 1, with the aim of avoiding defensive language. (see pages 9–10 and 13–15 of Agenda Item C.1)
Mr. Johnson also suggested making the material relating to the objective of the proposed AQ Framework more prominent within the document so that readers could understand the nature and purpose of the document. Ms. de Beer and Messrs. Hines and Pannier agreed.	Point accepted. The IAAB added a new box to the inside front cover highlighting the IAASB's vision for the AQ Framework, including its objectives. (See page 8 of Agenda Item C.1)
Mr. Koktvedgaard questioned how the AQ Framework would be used to enhance AQ, noting the interrelationship between auditor reporting and AQ.	Stakeholders are invited by Question 3 to the Consultation Paper to think creatively how they will use the Framework. (Question 3 of the Consultation Paper is reproduced above – see Matters for CAG Consideration 1(c).) During the September 2012 CAG meeting Mr. Grant also provided some examples of uses of the AQ Framework, e.g., by those charged with governance/audit committee members to contribute to enhancing AQ, and by audit firms in the areas of continuing professional development and training.
Mr. Koktvedgaard agreed with the draft document's position regarding the need for audit firms to leverage the AQ Framework to do more in the area of education and training, and also noted	Support noted.

Representatives' Comments	Task Force/IAASB Response
opportunities to use the AQ Framework more holistically including with respect to auditor reporting.	
Mr. Pannier inquired about how the AQ Framework would be harmonized with the auditor reporting project.	During the September 2012 CAG meeting Mr. Grant explained that the AQ Framework discusses the auditor reporting project at a high level, but does not duplicate the IAASB's work and deliberations thereon. Increasing the informational value of auditor's reports and improving perceptions of the value of the audit is included as an "Area to Explore". (See Appendix 1, Area to Consider #7, on page 65 of Agenda Item C.1)
Ms. Lang indicated that the survey on stakeholder perspectives in the appendices should be more prominent as it helps to set the tone of the document by describing what management or investors are particularly interested in when they think about AQ. Mr. Johnson noted that the CAG Working Group had similar thoughts regarding the survey summary and suggested that the Task Force consider whether the three graphics within the summary could be moved to the front of the document.	Point partly accepted. Reference to the survey has been included in the introduction to the Consultation Paper. However, in the interests of keeping the AQ Framework as short as possible, the IAAB agreed to abbreviate the Appendix containing the survey on stakeholder perspectives to two pages to focus on the key factors that stakeholder groups are likely to take into account in forming a view on the quality of an audit. Rather than including the details in the Framework itself, a link has been added to where the full results of survey, including related graphs, can be accessed. (See Appendix 2 on pages 67–68 of Agenda Item C.1)
Ms. Lang noted that the checklists included in the Appendix have value but may be seen as a move to a "checklist approach", which might undermine professional judgment. Mr. Hemus noted that checklists such as Appendix 2 may risk becoming de facto standards. He questioned whether a firm would ever answer in the negative to any question to avoid suggesting that the firm is not working towards improving AQ. He also suggested the need to ensure that the checklist is aligned with the ISAs, so that all the audit requirements and guidance were incorporated.	Point accepted. The IAASB agreed to remove the checklists. While the checklists aided in the development of the AQ Framework, the IAASB did not believe it was needed for the consultation phase. Once the Framework has been finalized and in the light of responses to Question 3 of the Consultation Paper the IAASB will reconsider the need for checklists as part of its roll-out plan.
Mr. Johnson questioned why the AQ Framework	In developing a Framework the IAASB was not

Representatives' Comments	Task Force/IAASB Response
used outputs as an indirect measure of AQ, rather than measuring AQ directly.	seeking to measure audit quality although the Framework may assist others who wish to attempt this. The IAASB's objectives in developing the AQ Framework are set out in the introduction. (See page 8 of Agenda Item C.1)
Ms. Blomme added that it might be worth considering outputs that are not in the auditor's report, for example, what auditors contribute to the enhanced quality of financial statements.	Point accepted. The Outputs described in the Framework extend beyond those matters that are covered by the auditor's report. (See page 43–47 of Agenda Item C.1) During the September 2012 CAG meeting, Mr. Grant also directed attention to the section of the draft Framework discussing auditors contributions to improvements in the financial statements. Among other matters, the AQ Framework highlights that an audit often results in management making changes to the draft financial statements.
Mr. Kuramochi noted that the AQ Framework should not be mistaken as a substitute for complying with the International Standards on Auditing (ISAs) or International Standard on Quality Control (ISQC) 1. ²	Point accepted. The IAASB agreed to emphasize, at the start of the proposed Framework, a box highlighting that “Auditors are required to comply with relevant auditing standards and standards of quality control within audit firms, as well as ethics and other regulatory requirements. The framework is not a substitute for such standards, nor does it establish additional standards or provide procedural requirements for the performance of audit engagements.” (See page 8 of Agenda Item C.1)
AREAS TO EXPLORE WHERE ACTIONS COULD BE TAKEN TO ENHANCE AQ	
Mr. Waldron supported the inclusion of “Areas to Explore,” noting that he found it helpful to have highlighted possible areas for exploration by audit regulators/inspectors and others and that this would be very well received by the CFA Institute. Ms. de Beer also supported the material, but suggested providing more context to better explain	Support noted. The Task Force expanded the areas to explore to better explain each of the areas and their context. (See Appendix 1 on page 64–66 of Agenda Item C.1)

² International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Service Engagements*

Representatives' Comments	Task Force/IAASB Response
the suggested areas for exploration and, perhaps, further addressing them outside of the AQ Framework.	
Mr. Pannier advised against including areas to explore, as the AQ Framework should stand on its own based on the best of today's knowledge. He suggested that, for purposes of the consultation paper, the section could be included as part of an accompanying document or an explanatory memorandum.	Point not accepted. The IAASB supported the inclusion of the areas to explore as a way of signaling areas for auditors and other participants in the financial reporting supply chain to consider what more could be done to enhance AQ in light of the AQ Framework.
Mr. Koktvedgaard noted that the survey results shown in the appendix underscore the importance of having audit regulation discussed in the Framework. He was of the view that audit inspections can positively impact AQ and that the AQ Framework should include a discussion of the role of audit regulators, including how the inspections might be better performed. Mr. Johnson agreed that the audit inspections process served an important role and expressed support for having the AQ Framework more fully address the role of audit oversight bodies.	Point accepted. Audit regulation is included as an Input to audit quality. (See page 41–42 of Agenda Item C.1) . Furthermore, following discussion with IFIAR, audit regulation, and particularly whether audit inspections can do more to improve AQ and to make AQ more transparent to users, is included in the revised and expanded areas to explore. (See Appendix 1, Area to Consider #4, on page 65 of Agenda Item C.1)
Mr. Waldron suggested that it would be useful to define audit failures, despite the report back explaining why the Task Force did not to accept this same point made by Mr. Hansen at the September 2011 CAG discussion.	Point not accepted. As explained in paragraph 143 of the Framework, audit failures can be difficult to define and may have a legal meaning in some countries. In simple terms, however, audit failure can be viewed as being the converse of audit quality. (See page 42 of Agenda Item C.1)
Mr. Uchino noted that the revised document was very useful. He also noted that in general fund managers and analysts would like to know more about how auditors assessed risks for particular clients and to have additional information on significant audit matters. Having such information disclosed in the auditor's report provides a trail of information over time.	Support noted. The points raised relate to IAASB's separate project to increase the informational value of auditor's reports.
Ms. Lang inquired whether the Task Force had given consideration as to how the information in	Point accepted. Once the Framework has been finalized and in the light of responses to the

Representatives' Comments	Task Force/IAASB Response
<p>the AQ Framework would be kept evergreen, including whether and how the revised IES 8³ would fit into the AQ Framework.</p>	<p>questions the IAASB will consider how best to keep the Framework current as part of its roll-out plan. At this stage in its development IES8 fits with the Framework because, as Mr. Grant noted members of the Task Force included representation from the IAASB, IESBA and the International Accounting Education Standards Board (IAESB).</p>
<p>Messrs. Hansen, Hines and Uchino noted the need for greater sharing of best practices on the exchange of information between firms in connection with audit appointments across audit firms and jurisdictions.</p>	<p>Point accepted. (See Appendix 1, Area to Consider #3, on page 64 of Agenda Item C.1)</p>
<p>CONTEXTUAL FACTORS</p>	
<p>Mr. Baumann suggested that the tone of the sections of the document describing the audit regulators' role be amended. He was of the view that it would likely be poorly received by the members of International Forum of Independent Audit Regulators (IFIAR), for example, as it might be perceived as instructing them on how to exercise their oversight responsibilities. He also noted that messages such as "an overly regulated environment acting as a disincentive for talented individuals to join the profession," and "there is no indication of how to define an audit failure," in particular, would be controversial.</p>	<p>Point accepted. The Task Force has revised several relevant paragraphs and the draft wording was made available to IFIAR. (See page 42 of Agenda Item C.1)</p>
<p>Mr. Baumann pointed out that there may be other useful outputs in evaluating AQ, for example, assessments of restatements of financial statements and the inspection findings remediation process and other related communications. In particular, he suggested that the Task Force give further consideration and prominence to describing how the audit inspection process identifies deficiencies, and to promoting the development of</p>	<p>Points accepted. Reference has been made to actions taken to address weaknesses in paragraph 138 and to restatements of the financial statements in paragraph 164. (See pages 41 and 46 of Agenda Item C.1)</p>

³ International Education Standard (IES) 8, *Competence Requirements for Audit Professionals*

Representatives' Comments	Task Force/IAASB Response
<p>an inspection finding remediation process that can then be communicated across all partners and staff in the audit firm. In his view, this enhancement would contribute to improving AQ.</p>	
<p>Regarding the discussion of public reporting of audit inspection findings, Mr. Grund noted that, though the Task Force did not seek to conclude on whether public reporting supported audit quality, he believed that addressing the topic in the publication was beneficial.</p>	<p>Support noted.</p>
<p>Mr. Stewart expressed a view that the material relating to fair values and significant measurement uncertainty appeared negative. He suggested that, if an entity's business involves significant use of fair value estimates, one positive outcome could be that it would call for use of a specialist(s) by the auditor, which would likely result in having appropriate staffing for the audit engagement. Mr. Stewart also recalled views expressed from the previous day's New York Auditor Reporting Roundtable which indicated that two-way discussions between the auditor and management regarding fair values and ranges of estimates is a positive development.</p>	<p>Point noted. However, the IAASB does not intend this material to be viewed as a negative comment on accounting requirements but rather as a comment on audit challenges they give rise to.</p>
<p>Mr. Stewart noted that recognition and measurement are integral parts of the accounting standards, but accounting standards are not intended to address documentation of management's rationale as may be suggested by the AQ Framework.</p>	<p>Point noted. Paragraph 218 (final bullet point) observes that the lack of documentation presents a challenge to auditors. (See page 55 of Agenda Item C.1)</p>
<p>Mr. Hemus suggested that the AQ Framework should provide more on the governance of audit firms, in particular as it relates to the relationship between audit firms and audit networks. He expressed a view that many audit firm networks share audit methodologies, but lack a common accountability framework. Accordingly, Mr. Hemus suggested that the AQ Framework addresses what audit firms can do to share information about audit</p>	<p>Point partially accepted. There is an area to explore dealing with developing best practice guidance on audit firm corporate governance (See Appendix 1, Area to Consider #1, on page 64 of Agenda Item C.1). Whistle blowing would likely be part of any such guidance.</p> <p>Issues relating to group audits have now been</p>

Representatives' Comments	Task Force/IAASB Response
<p>deficiencies within the firm structure. He also inquired as to whether the Task Force gave consideration to “whistleblowing” for circumstances where best practices were not followed.</p>	<p>integrated into the inputs (rather than being dealt with as ‘add-on’ considerations alongside public sector audits and audits of smaller entities). In so doing the IAASB added material addressing aspects of audit network arrangements, including descriptions of areas of commonality. (See paragraph 129 on page 40 of Agenda Item C.1)</p>
<p>Ms. Lang suggested that the natural flow of the document could be improved if the description of the IESBA Code⁴ was positioned before the discussion of matters affecting independence. Ms. Lang also suggested that the SMP Considerations section should be positioned first in the draft, to adopt a “think small first” approach. She also noted that the paragraph on “Business Practices and Information Systems” seemed out of place and suggested rephrasing to be more general.</p>	<p>Points generally not accepted.</p> <ul style="list-style-type: none"> • The IAASB considered that the discussion on the IESBA Code was correctly positioned in the context values, ethics and attitudes at the national level. • The IAASB did not agree that the Framework should specifically reflect a “think small first” approach. It believes that the vast majority of attributes apply to audits of all sizes. • The comments on “Business Practices and Information Systems” in paragraph 262 were reviewed.
<p>Mr. Pannier suggested that section addressing public sector considerations be deleted, noting that the level of detail was inappropriate.</p>	<p>Point not accepted. During the September 2012 CAG meeting Mr. Grant noted that an IAASB member representing the public sector is on the Task Force and strongly supported this section as it was important to include specific considerations for the public sector. The IAASB concurred with this view.</p>
SUMMARIZATION AND PACKAGING	
<p>Ms. de Beer suggested moving some of the contextual factors relating to the responsibilities of other stakeholders out of the main document to an Appendix, noting that it would also help address concerns raised about the tone and balance of the document by Mr. James.</p>	<p>Point not accepted. The IAASB believed that the contextual factors are best located within the document to give a holistic view of AQ.</p>

⁴ IESBA Code of Ethics for Professional Accountants (IESBA Code), paragraph 100.5

Representatives' Comments	Task Force/IAASB Response
<p>Mr. Morris commented that the document was too long and suggested extracting a core of about 20 pages or so, and adding discrete appendices to address the responsibilities of those charged with governance/audit committees and regulators. Mr. White disagreed, as he was of the view that the information in the document achieved the right balance and was a good educational document for all stakeholders.</p>	<p>The IAASB is sensitive to concerns about the length of the document and has taken some action to shorten it. Nevertheless, the IAASB preferred a fully described Framework at least for purposes of the consultation phase. The IAASB intends to return to the subject of packaging in the light of responses to the Consultation Paper and question 3 in particular.</p>
<p>Ms. Lang and Mr. Kuramochi suggested the AQ Framework be published electronically on the web with hyperlinks to enable users to access relevant parts as needed.</p>	<p>This will be considered when the final version of the Framework is finalized. The Consultation Paper version of the AQ Framework includes a linked table of contents allowing users to navigate and access relevant parts as needed.</p>

Material Presented – IAASB CAG PAPER

Agenda Item C.1

IAASB Consultation Paper, *A Framework for Audit Quality*

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 December 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><u>September 2012</u></p> <p>See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_C_ISA_720-Issues-v3.pdf</p> <p>See CAG meeting minutes (in Agenda Item B of the following) See draft September 2012 CAG meeting minutes at Agenda Item A. See report back on September 2012 CAG meeting in Paragraph 7 of this CAG paper.</p>
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