

Invitation to Comment—Responding to Public Interest Calls to Enhance Audit Quality—Issues and Working Groups’ Recommendations**I. Discussion on the Forepart of the ITC****Format of the Proposed ITC**

1. In finalizing its [Work Plan for 2015–2016](#), the IAASB agreed that projects on quality control, group audits, special audit considerations related to financial institutions (‘financial institutions’) and professional skepticism should be prioritized. The responses to the Invitation to Comment (ITC) will be used as a basis to inform standard-setting project proposals, with project proposals for quality control and group audits expected to be presented at the September 2016 IAASB Consultative Advisory Group (CAG) and IAASB meetings.
2. The draft ITC (as presented in **Agenda Item F.2**) comprises of two parts:
 - Part I: The forepart (see paragraphs 4–5 below explaining the contents of the forepart)
 - Part II: *Exploring the IAASB’s Suggested Enhancements in Relation to Specific Projects*: including Quality Control (see paragraphs 16–32 below for relevant discussion related to quality control) and Group Audits (see paragraphs 33–37 below for relevant discussion related to group audits).

Discussion about the content of the ITC relating to financial institutions and professional skepticism can be found below in paragraphs 8 and 9–11, respectively.

3. Input from discussions with CAG Representatives and Observers, as well as from IAASB discussions, will be used to further refine the ITC for final discussion with the IAASB in December 2015.
4. The forepart of the proposed ITC (paragraphs 1–59 of **Agenda Item F.2**) is intended to provide a broad view of the issues identified relating to the IAASB’s priority projects, soliciting views through the use of broad questions on the individual topics. It has been intentionally designed to appeal to a wider audience of stakeholders (for example, those that have broad interest in audit-related matters and who wish to provide input on the significant issues on a more overall basis, such as investors or audit committee members). This approach is consistent with that taken in the IAASB’s Auditor Reporting ITC, which was well-received by those stakeholders, including those who may not frequently comment on the IAASB’s Exposure Drafts.
5. The forepart of the ITC is intended to:
 - Provide context for the ITC, including making the link to the IAASB’s [Framework for Audit Quality](#).
 - Introduce the crossover issues between the priority projects, explaining the interactions and referring to the more detailed sections presented in Part II of the ITC, enabling respondents to understand such connections and to comment more effectively.
 - Introduce matters of significance in the individual projects, especially those matters that are common to many of the issues identified relating to each project or those which have already been identified as key issues by stakeholders.

6. In addition, the forepart will serve as the basis for the various roadshows and outreach events that will be planned for 2016. The use of broad questions on the key topics, as well as more holistic questions relating to audit quality, may be used as a basis for discussions to identify what actions may be needed by the Board and others to enhance audit quality in the public interest. Where relevant, this may also be replaced or supplemented with the more focused questions on the specific topics to facilitate more targeted outreach on specific matters for certain projects.
7. Part II of the ITC sets out the most significant issues relating to the IAASB's projects on quality control and group audits and its deliberations to date. This section also provides the IAASB's initial views on possible actions to address the issues identified, and more detailed questions to solicit specific feedback from respondents on these possible actions. It includes discussion of the input and feedback from regulators and audit oversight bodies, the IFAC Small and Medium Practices (SMP) Committee,¹ outreach activities (including meetings of the Forum of Firms, national auditing standard setters (NSS) and the CAG, and WG and IAASB discussions). Coordination with representatives of the International Organization of Supreme Audit Institutions (INTOSAI) is also planned in advance of the issuance of the ITC in order to reflect specific considerations applicable to the public sector.

Financial Institutions

8. Part II of the ITC will also include a specific section on the topic of financial institutions, including consideration of issues related to ISA 540.² However, limited details on this topic have been included in the draft ITC included as **Agenda Item F.2**, pending further work by the Financial Institutions Working Group (FIWG) to develop and finalize the relevant issues to be addressed in the ITC. The FIWG's work will be informed by discussions with the CAG and the IAASB at their respective September 2015 meetings. It is envisaged that matters outlined in **Agenda Item D** will be addressed to some degree in the ITC, subject to input provided by the IAASB and the CAG.

Professional Skepticism

9. The 2015–2016 Work Plan set out that the IAASB would undertake initial work to explore the nature of the issues related to professional skepticism to further understand what could be done in this area before committing to a project on this topic.³ Paragraphs 51–59 of the forepart in **Agenda Item F.2** highlights professional skepticism as an overarching topic that affects many (if not all) of the IAASB's projects.
10. The discussion in the ITC builds upon the panel session held during the June 2015 IAASB meeting and the Board's reflections to date. The topic of professional skepticism will be further explored as described in **Agenda Item B** at the CAG's September 2015 meeting, and will also be discussed with the IAASB at its September 2015 meeting. The IESBA and the IAESB have not yet considered the topic in detail.

¹ **Agenda Item F-2** includes perspectives related to SMPs and audits of small- and medium-sized entities, which may be further enhanced before the ITC is issued as a result of ongoing coordination with the SMP Committee.

² ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

³ The Professional Skepticism Working Group (PSWG) has recently commenced its activities, and is a joint working group of the IAASB, the International Ethics Standards Board for Accountants (IESBA) and International Accounting Education Standards Board (IAESB).

11. The intent of highlighting the topic of professional skepticism in the ITC is to commence the dialogue of this complex topic with stakeholders and begin to solicit feedback on what actions the IAASB or others could take to strengthen the application of professional skepticism in audits of financial statements.⁴ A high-level question about the topic of professional skepticism will also be included (see **Agenda Item F.2**, Question 7) and feedback will be considered by the PSWG as it develops its recommendations to the IAASB and the other standard-setting boards as to a way forward.

Highlighting the Work of Others Relating to Audit Quality

12. The IAASB's [Framework for Audit Quality](#) recognizes the important role other stakeholders play in audit quality. While there may be limits as to what the IAASB alone can achieve in its role as an international standard setter, many others have undertaken important initiatives that are or may be relevant to enhancing audit quality. The Audit Quality Enhancements Coordination Group (AQECG), the group responsible for the development of the forepart as well as overall coordination of the overall ITC, as well as the individual working groups (WG), believe that it is important the ITC highlights these initiatives. Also, in considering feedback to the ITC, the IAASB may find it necessary to work with other stakeholders and request them to take actions to complement IAASB standard-setting and other activities on the topics of quality control, group audits, financial institutions and professional skepticism.
13. As such, the AQECG intends to develop an Appendix for inclusion in the final ITC that makes reference to others of relevance in the reporting supply chain, or that may be undertaking activities that may be of relevance to the IAASB's work. Topics identified to date to be highlighted include:
 - The role of audit committees (e.g., highlight the work of the UK Financial Reporting Council, US Securities Exchange Commission (SEC), Organization for Economic Co-operation and Development (OECD), Center for Audit Quality (CAQ) in the US, etc.) .
 - Transparency reporting by audit firms (e.g., highlight developments in the UK and in other jurisdictions).
 - Relevant projects on the IESBA's agenda, including its projects addressing long association of senior personnel and the related safeguards, and responding to non-compliance with laws and regulations (NOCLAR).
 - Activities of the accounting standard setters and national auditing standard setters directly related to the IAASB's priority topics (e.g., activities to address responsibilities for direction and supervision of audit engagements and the International Accounting Standards Board's projects on disclosures and materiality).
 - Others as identified through the IAASB and CAG September 2015 discussions.

Readability, Balance and Completeness of the ITC to Solicit Feedback

14. There is a balance to be struck between the length of the ITC, including the forepart, and the need to provide an appropriate amount of detail to obtain specific feedback sufficient to enable the IAASB to effectively scope its future standard-setting (or other) projects. The development of the initial draft

⁴ For example, in the panel session at the June 2015 IAASB meeting, one panelist reflected on whether the construct of the requirements in the ISAs are written in a way that promotes a mentality of corroborating management's numbers, as opposed to a more neutral or challenging mindset.

has been an iterative process, and will continue to evolve as each of the individual WGs advance their thinking. As the document is finalized for discussion at the December 2015 IAASB meeting, Staff will further consider the format and presentation of the consultation document in coordination with the AQECG and WGs.

15. The AQECG is also considering whether more explanation is needed regarding some of the commonly used terms incorporated in the discussions within ITC to enhance its readability and ensure a common understanding by respondents of the issues, for example, the use of “network of firms”—where the intended meaning as used throughout the ITC is broader than how ‘network firms’ is defined in the ISAs (see further discussion on paragraphs 26 and 73–79 in **Agenda Item F.2** on network of firms).

Matters for CAG Consideration – Main Session

1. CAG Representatives and Observers asked for their views on the forepart of the draft ITC as presented in **Agenda Item F.2**, in particular:
 - (a) Whether the forepart provides sufficient detail for respondents to understand the issues, but at a level that is understandable to those that only have a broad interest in audit-related matters (i.e., has the correct balance been achieved);
 - (b) The completeness of the issues that have been identified in the forepart and the clarity of the related descriptions, including whether it is clear how the issues are related and why they have been prioritized for discussion in the forepart;
 - (c) The appropriateness of the questions (questions 1–7 of **Agenda Item F.2**) in the forepart of the ITC to solicit feedback, taking into account the more detailed questions included in Part II of the ITC;
 - (d) Any other matters relevant to the forepart of the ITC, or the ITC more generally, for further consideration by the AQECG or the individual working groups in advance of the December 2015 IAASB meeting.
2. CAG Representatives and Observers are also asked to share:
 - (a) Initiatives or activities of their Member Organizations or others (beyond those identified in paragraph 13 above) that should be highlighted in the ITC.
 - (b) Suggestions on any specific considerations related to SMEs/SMPs or the public sector that may be relevant to highlight within the ITC.

II. Quality Control

16. The Quality Control Working Group (QCWG) developed the quality control section in the draft ITC (paragraphs 63–164 of **Agenda Item F.2**) using the issues discussed with the IAASB at the June 2015, March 2015, December 2014 and June 2014 IAASB meetings as a basis, including the feedback from the March 2015 CAG meeting.

17. In particular, the QCWG focused on refining how the discussions on the following topics have been presented in the ITC:
- Quality control policies and procedures when operating through a network of firms (see paragraphs 18–27 **of this paper**)
 - Transparency reporting (see paragraph 28 **of this paper**)
 - Development of a separate engagement quality control review (EQCR) standard (see paragraphs 29–32 **of this paper**)

Note to the CAG: Views on the first three topics (above) are welcome during the main session. The remaining topics in this list (below) are expected to be addressed in greater detail during the breakout session.

- Leadership responsibilities for quality within the firm (see paragraphs 63–72 of **Agenda Item F.2**)
- Monitoring and remediation (see paragraphs 80–89 of **Agenda Item F.2**);
- Engagement partner performance and rewards systems (see paragraphs 90–100 of **Agenda Item F.2**);
- Human resources (see paragraphs 101–105 of **Agenda Item F.2**);
- Engagement partner definition and responsibilities (see paragraphs 106–121 of **Agenda Item F.2**);
- Engagement partner competencies (see paragraphs 122–132 of **Agenda Item F.2**);
- Engagement quality control reviews and engagement quality control reviewers (see paragraphs 133–140 of **Agenda Item F.2**);
- Exploring the potential effects that audit firm's changing business models and structures have on audit quality (see paragraphs 141–149 of **Agenda Item F.2**); and
- Exploring a Quality Management Approach to Updating ISQC 1 and ISA 220 (see paragraphs 156–164 of **Agenda Item F.2**).

Quality Control Policies and Procedures throughout the Audit Firm, Including When Operating through a Network of Firms

18. [Agenda Item 12-A](#) of the June 2015 IAASB meeting agenda materials compared the requirements and application material contained in ISQC 1 to various sources of guidance relating to governance codes and audit quality. The IAASB agreed with the QCWG's identification of the areas for improvement, while at the same time, requested additional considerations on how the elements contained in ISQC 1, specifically those related to governance, should take into account the fact that some audit firms operate within a network of firms.
19. Audit firms choose to organize themselves using many different types of arrangements. ISQC 1 makes reference to the fact that some audit firms operate through a network of firms.
20. ISQC 1 defines the term “network” as a larger structure:
- That is aimed at cooperation, and

- That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
21. The IESBA *Code of Ethics for Professional Accountants* (IESBA Code) also contains guidance as to what constitutes a network firm.⁵
 22. Audit firms that operate through a network of firms may share common methodologies, and quality control and monitoring policies and procedures. These audit firms may seek to rely on the network’s system of quality control, including monitoring policies and procedures, in addressing certain of the audit firm’s responsibilities under ISQC 1. Paragraph 4 of ISQC 1 notes that “the nature and extent of the policies and procedures developed by an individual firm to comply with this ISQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.”
 23. While certain requirements in ISQC 1 relating to independence⁶ and monitoring⁷ acknowledge the possibility of certain processes occurring at the network firm level, ISQC 1 as a whole applies to the audit firm level, rather than the network level.
 24. The following factors are often observed in these arrangements:
 - Audit firms within the network are not owned or controlled by the network entity for various reasons, including jurisdictional law and regulation and risk and litigation management purposes.
 - The extent of operational and decision-making power at the network level is limited. Compliance at the individual audit firm level with shared common methodologies, and quality control and monitoring policies and procedures, can be influenced through economic and other measures, but often cannot be centrally controlled.
 25. In the cases where an audit firm seeks to place reliance on policies and procedures at the network level to meet requirements under ISQC 1, it has been observed that the definitions of “network” and “network firm” in ISQC 1 and the IESBA Code may not be fit for purpose. Those definitions place more emphasis on the independence and ethical aspects associated with being part of a network, as opposed to the implications of seeking to rely on network policies and procedures to meet the audit firm’s responsibilities under ISQC 1.
 26. Where audit firms seek to place reliance on policies and procedures at the network level to meet the audit firms requirements under ISQC 1, the QCWG is of the view that additional requirements or application material or clarifications of existing requirements and application material, as suggested in paragraphs 77–79 of **Agenda Item F.2**, would be necessary to address the issues that have been raised. Regulators and audit oversight bodies have expressed concerns about overreliance on network firm policies and procedures without an appropriate basis for doing so, as well as concerns that networks are not adequately considering the results of external inspection findings of individual network firms and their implications to the network as a whole.

⁵ See paragraphs 290.13-290.24 for guidance on what constitutes a network firm.

⁶ ISQC 1, paragraph 21

⁷ ISQC 1, paragraph 54

27. The QCWG does not believe that placing requirements in ISQC 1 or the development of a separate “ISQC 1 like” standard that applies at the network level is feasible due to the factors noted above related to how networks are typically established and the limited extent of operational and decision-making power at the network level.

Transparency Reporting

28. The QCWG considered the feedback received from the IAASB at its June 2015 meeting related to the inclusion of the topic of transparency reporting within the ITC. The QCWG discussed the aspect of transparency reporting at its working group meeting in July 2015, informed by a summary performed by IAASB Staff of current practices related to transparency reporting. On balance, the QCWG does not believe it would be appropriate, at this time, for the IAASB to incorporate, in ISQC 1, transparency reporting by firms as the practice is still evolving (see paragraphs 150–155 of **Agenda Item F.2**). However, the ITC will acknowledge the efforts by others in this area in the Appendix (see paragraph 13 of this paper) to potentially encourage greater use of this in practice and the potential establishment of requirements by those best placed to do so.

Development of a Separate Engagement Quality Control Review Standard

29. At its June 2014 meeting, the IAASB considered moving the EQCR section of ISQC 1 into a separate standard that would apply when an EQCR was required either by the ISAs (i.e., for audits of financial statements of listed entities) or as determined by the audit firm, as an alternative to retaining the EQCR section within ISQC 1 and to develop further requirements or application material.
30. Development of a separate EQCR standard could have the following advantages and disadvantages:

Advantages

- Greater prominence of the contribution of the EQCR to audit quality through increased focus being provided through use of a separate standard.
- Allowance for greater elaboration of requirements and application material for an EQCR (including in relation to proportionate application or application to other types of assurance or related services engagements), without distorting the balance of EQCR relative to other aspects of ISQC 1.
- May help address the issues of applicability and scalability of ISQC 1 which have been highlighted by SMPs.

Disadvantages

- Linkages to and with the overall framework of ISQC 1 may be missed.
 - Increased potential for duplication.
 - Potentially undue prominence on an EQCR in relation to other important factors in quality control, in particular the role of the engagement partner.
31. At the June 2014 IAASB meeting, a few IAASB members did not initially support the possibility of placing the requirements in ISQC 1 and ISA 220 relevant to EQCRs into a separate standard. At the March 2015 CAG meeting, some CAG Representatives and Observers expressed a view that there might be merit in continuing to consider whether a separate standard for EQCRs may be appropriate, in particular in light of their importance for listed entities.

32. The QCWG has further considered whether it may be useful to include a specific question in the ITC regarding a separate standard for the requirements in ISQC 1 and ISA 220 relevant to EQCRs. This would allow respondents to specifically comment on this and provide the IAASB with stakeholders’ views on whether this needs to be considered for the project proposal. However, in discussing this matter, the QCWG does not recommend including a question on this in the ITC as it is of the view that the disadvantages of placing the requirements in ISQC 1 and ISA 220 relevant to EQCRs into a separate standard outweigh the advantages.

Matters for CAG Consideration – Main Session

3. CAG Representatives and Observers are invited to share views on the matters outlined in paragraphs 18–32 of this paper, including how these topics have been addressed in the related paragraphs of **Agenda Item F.2**.

Matters for CAG Consideration – Breakout Session

4. CAG Representatives and Observers are asked for their views on:
- (a) The quality control section of the ITC as presented in **Agenda Item F.2**, including the completeness of the issues that have been identified and the possible actions to address the identified issues, and the clarity of the related descriptions.
 - (b) The appropriateness of the specific questions on quality control as presented in **Agenda Item F.2** (namely, Questions 8–25 in **Agenda Item F.2**).

III. Group Audits

Process to Develop the ITC

Involvement of Other Auditors in the Audit

33. Situations involving component auditors (i.e., in a group audit) are addressed by ISA 600. In developing the [Staff Audit Practice Alert](#),⁸ published in August 2015, the GAWG identified that in some cases audits may involve other auditors who are not component auditors (i.e., are considered *other auditors* as they do not meet the definition of component auditors). Paragraph 2 of ISA 600 notes that in these circumstances, ISA z600 may be applied, adapted as necessary, but apart from this reference the ISAs do not explicitly address the involvement of other auditors. This is viewed by some, including regulators and audit oversight bodies, as a gap in the IAASB’s literature.
34. The involvement of other auditors in engagements is becoming more prevalent in practice as the environment continues to evolve. The AQECG and GAWG believe this is likely a crossover issue, and that more specificity in the ISAs on addressing situations involving other auditors would be beneficial (see paragraphs 29–30 of **Agenda Item F.2**).

Group Audits Section of ITC

35. The GAWG has developed the group audits section in the draft ITC (paragraphs 165–259 of **Agenda Item F.2**) using the issues discussed with the IAASB at the June 2015 IAASB meeting as a basis,

⁸ Staff Audit Practice Alert, *Responsibilities of the Engagement Partner in Circumstances when the Engagement Partner is Not Located Where the Majority of the Audit Work is Performed*—

but also incorporating the feedback from the March 2015 CAG meeting. Various discussions with members of the Independent Forum of Independent Audit Regulators (IFIAR) Standards Coordination Working Group (SCWG) and representatives of the Global Public Policy Committee (GPPC) of the six largest accounting networks have also provided useful perspectives related to the issues noted in [Agenda Item 9-A](#) of the June 2015 IAASB meeting agenda materials as areas where more information gathering was necessary.

36. In addition to the crossover issue relating to “other auditors involved in the audit,” as discussed above, other crossover issues were identified and the group audit aspects of these discussed in the forepart (e.g., relating to the potential effects of audit firm’s changing business models and structures on audit quality (including increasing use of shared service centers); and engagement partner responsibilities where the engagement partner is not located where the majority of the audit work is performed). The group audits section of Part II builds on the discussion of the crossover issues discussed in the forepart.
37. In particular, the GAWG has focused on refining how the discussions on the following topics have been presented in the ITC:
- Acceptance or continuance of group audit engagements, including understanding and considering the impact on this decision of restrictions on access to component management or component auditors (see paragraphs 165–178 of **Agenda Item F.2**).
 - Appropriate communications between the group engagement team and component auditors (see paragraphs 179–186 of **Agenda Item F.2**).
 - The implications for the group engagement team’s understanding of component auditors when a component auditor has the same policies and procedures as the group engagement team (see paragraphs 189–190 and 196 of **Agenda Item F.2**).
 - The group engagement team’s involvement in the work of the component auditor (see paragraphs 197–206 of **Agenda Item F.2**).
 - Understanding the components and identifying significant risks (see paragraphs 207–219 of **Agenda Item F.2**).
 - Component materiality and other aspects of materiality relevant to group audits (see paragraphs 220–226 of **Agenda Item F.2**).
 - Distinguishing procedures to be performed on component’s information (see paragraphs 227–234 of **Agenda Item F.2**).
 - Situations where there are only non-significant components, or a large number of non-significant components (see paragraphs 235–239 of **Agenda Item F.2**).
 - The group engagement team’s involvement in the consolidation process (see paragraphs 240–248 of **Agenda Item F.2**).
 - Reviewing and evaluating the work of the component auditors (see paragraphs 249–258 of **Agenda Item F.2**).

Matters for IAASB Consideration – Breakout Session

5. CAG Representatives and Observers are asked for their views on:
- (a) The group audits section of the ITC as presented in **Agenda Item F.2**, including the completeness of the issues that have been identified and the possible actions to address the identified issues, and the clarity of the related descriptions.
 - (b) The appropriateness of the specific questions on group audits as presented in **Agenda Item F.2** (namely, Questions 26–37 in **Agenda Item F.2**).