

Enhancing Audit Quality in the Public Interest—A Focus on Quality Control, Group Audits and Professional Skepticism

An Overview of the IAASB's Invitation to Comment

Across all parts of the world, 110 countries currently use the IAASB's International Standards on Auditing (ISAs) (or are committed to using them in the future) as the basis for high-quality audits of entities of all sizes in all sectors.

The IAASB's [Strategy for 2015–2019](#) sets out three strategic objectives for the period. The first and most important strategic objective is to ensure that the ISAs continue to form the basis for high-quality, valuable, and relevant audits conducted worldwide by responding on a timely basis to issues noted in practice and emerging developments.

With this strategic objective in mind, the [IAASB's Work Plan for 2015–2016](#) ("the Work Plan") committed to give priority to key topics addressed in the ISAs, including quality control; group audits; professional skepticism; and special considerations in audits of financial institutions (including the application and potential revision of ISA 540).¹

At its December 2015 meeting, the IAASB will be asked to approve a project proposal to revise ISA 540, including considering the potential need for guidance for auditors in light of developments in financial reporting standards. In addition, the IAASB will give further consideration to financial institutions and whether changes to the standards, or further guidance, is needed. Accordingly, these topics are not specifically addressed by this consultation.

The purpose of this consultation is to explore how the IAASB might best address, in the public interest, the calls for enhanced audit quality in the areas of quality control, group audits and professional skepticism. This consultation is being performed at an early stage of the work on these topics, as the IAASB has learned that early consultation on directional issues and public interest matters to be addressed facilitates more effective standard setting.

This overview of the Invitation to Comment (ITC) is specifically designed to introduce the matters that the consultation will address. In particular, the overview is intended to facilitate responses from users and preparers of financial statements and audit committees and their organizations.

The separate ITC publication is a more detailed discussion document, which provides greater and more technical details on how the IAASB's standards currently address specific matters related to the topics of quality control, group audits and professional skepticism, concerns that have been noted, and possible actions the IAASB may undertake to address these concerns. The ITC includes more detailed questions on specific potential areas for improvements within the IAASB's standards.

Table of Contents	Page
Audit Quality: The Interplay between the IAASB's Work and Its Stakeholders	2
Why Are Changes to the ISAs Needed?	3
Taking Action in the Public Interest	5
Strengthening Quality Control Requirements and Guidance	7
The Need for an Enhanced Auditing Standard Addressing Group Audits	15
Strengthening Professional Skepticism in the Audit	16
Questions	18

¹ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Audit Quality: The Interplay between the IAASB's Work and Its Stakeholders

What Is a Quality Audit?

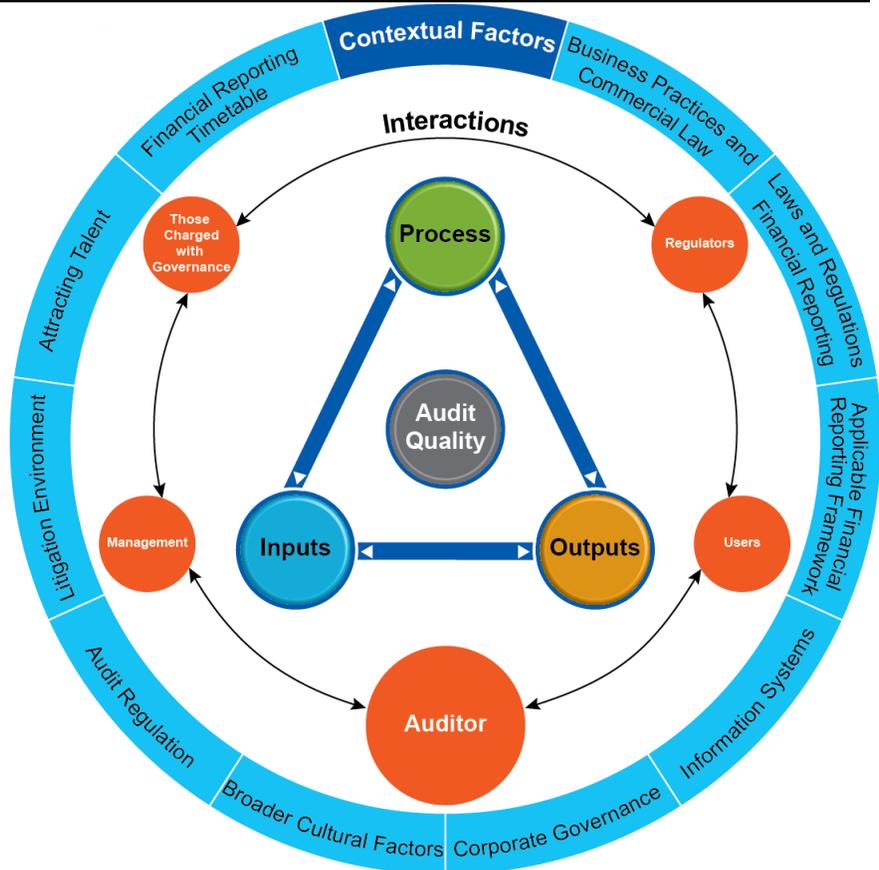
The term **audit quality** encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis.

The objective of an audit of financial statements is for the auditor to form an opinion on the financial statements based on having obtained sufficient appropriate audit evidence about whether the financial statements are free from material misstatement and to report in accordance with the auditor's findings. A quality audit is likely to have been achieved by an engagement team that:

- ❖ Exhibited appropriate values, ethics and attitudes;
- ❖ Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- ❖ Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards;
- ❖ Provided useful and timely reports; and
- ❖ Interacted appropriately with relevant stakeholders.

- Paragraphs 1–2 of the IAASB's Framework for Audit Quality (2014)

1. The IAASB's [Framework for Audit Quality](#) (the Framework) was developed to raise awareness of key elements of audit quality, encouraging stakeholders to explore ways to improve audit quality, and facilitate dialogue between key stakeholders on the topic. The Framework also highlights important inputs to audit quality – with the ISAs being a critical input. The IAASB's focus in this consultation is on where improvements to the ISAs may be needed in the public interest to enhance audit quality.



In this graphic, “those charged with governance” refers to those who have responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including oversight of the financial reporting process (e.g., Boards of Directors, Audit Committees or similar). Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.

Why Are Changes to the ISAs Needed?

THE BUSINESS ENVIRONMENT IS CHANGING

2. The way that businesses are structured continues to evolve and increase in complexity, in particular as entities operate more globally and may become more decentralized. Advances in technology (including the use of “big data”) can facilitate increased business integration, as well as allow for greater strategic flexibility. Law or regulation may create tax or other incentives based on how and where entities are domiciled, and therefore also influence how entities choose to structure themselves.
3. Entities are increasingly using shared service centers to enhance the efficiencies of their operations and potentially save costs. Integrated reporting and other emerging forms of external reporting are being used to communicate more effectively about organizations and how they create and sustain value. Financial reporting frameworks are also evolving, increasingly requiring significant management judgment as fair value measurements become more prevalent. More forward-looking information is used as the basis for recognition or measurement or is required to be disclosed in the financial statements.
4. In recognition of their important role in enhancing audit quality, audit committees are being called on to become stronger and more active;² not only with regard to their interactions with auditors, but also as it relates to their responsibilities for oversight of management and the financial reporting process.

AUDIT FIRMS’ BUSINESS MODELS AND THE WAY AUDITS ARE BEING CONDUCTED ARE CHANGING

5. The changing business and regulatory environment has affected how audits are carried out, in particular audits of multi-national entities (which are often “group audits”). Audit firms of all sizes are also facing resource challenges as they adapt to the pace of change in these environments, including difficulties in attracting and retaining suitably qualified individuals to the auditing profession.
6. As a result, audit firms are contemplating their own structures and how best to organize engagement teams and conduct audits, with a view towards performing high-quality audits at a reasonable cost.
7. Audit firms of all sizes are structuring themselves in many and varied ways, adding complexity to how the audit firm’s and the engagement partner’s responsibilities are executed in support of quality audits.
8. Members of an audit engagement team may no longer all be located in the same place – historically the traditional audit model. Rather, members may now be in different jurisdictions or time zones. Many audits are therefore being conducted more virtually, and auditors are using advanced technologies and new work methods to collaborate with one another and communicate with management of the entities that they are auditing. The IAASB refers to these as audit delivery models (ADMs), which term is intended to encompass terms such as “audit firm shared service centers,” “centers of excellence,” “on-shoring,” “offshoring,” or “outsourcing.”

² For example, the Organisation for Economic Co-operation and Development (OECD) revised its the Principles of Corporate Governance, issued in 2015 and endorsed by the G20 Finance Ministers. These principles serve as the basis for the guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision. Audit committees may also be required to report externally on how they discharged their responsibilities (e.g., in the UK).

STAKEHOLDERS HAVE CALLED ON THE IAASB TO ADDRESS ISA IMPLEMENTATION MONITORING PROJECT FINDINGS AS WELL AS EXTERNAL INSPECTION FINDINGS

9. The IAASB recognizes the importance of being aware of whether its public interest aims are being achieved and is committed to doing so through post-implementation reviews and outreach activities.

The IAASB's ISA Implementation Monitoring project findings³ indicated that improvement to aspects of some ISAs is necessary to achieve greater consistency and effectiveness in their application.

10. Ongoing collaboration with the International Forum of Independent Audit Regulators (IFIAR) and its Standards Coordination Working Group, and the International Organization of Securities Commissions (IOSCO), and ongoing dialogue with audit firms, national auditing standard setters (NSS) and others, keeps the Board apprised of areas where improvements to the standards may be needed, or where other actions to enhance auditor performance may be appropriate.

Audit Firms

11. Audit firms have identified areas for improvements within the ISAs and ISQC 1, noting the need for the development of internal methodologies and guidance to bridge perceived gaps or difficulties in applying the principles-based ISAs to various circumstances.
12. Concerns also continue to be expressed by the small and medium practices (SMP) community that more is needed to better support them in effectively applying the ISAs and ISQC 1 to smaller or less complex entities.

Regulators and Audit Oversight Bodies

13. Publicly reported inspection findings consistently highlight areas where quality audits are not being performed and emphasize the need for actions by auditors to continuously improve audit quality. [IFIAR's 2014 Summary of Inspection Findings](#) highlights persistent deficiencies in important aspects of audits, including with respect to audit firms' systems of quality control, quality control at the engagement level, group audits and professional skepticism.⁴
14. Regulators and audit oversight bodies have also highlighted concerns with how auditors are addressing accounting estimates (including fair value measurements); noting instances where professional skepticism does not appear to be appropriately applied. These stakeholders are calling for more robust requirements in the ISAs to direct how the auditor obtains sufficient appropriate audit evidence in relation to significant accounting estimates, including more granularity relating to evaluation of management's assumptions and consideration of indicators of management bias. The IAASB's project to revise ISA 540 will consider these issues.

³ This post-implementation review focused on obtaining input through a variety of different channels and from a wide range of stakeholders to learn about adoption and implementation issues related to the clarified ISAs and 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*, which became effective in 2009.

⁴ Matters relevant to quality control and group audits are further discussed in the sections *Strengthening Quality Control Requirements and Guidance* and *The Need for an Enhanced Auditing Standard Addressing Group Audits* of this overview, as well as in more detail in the ITC.

Taking Action in the Public Interest

[Design note: Timeline graphic to be inserted here to highlight issuance of ITC, comment period close date, analysis by working groups, September 2016 Board and CAG meetings at which project proposals will be discussed, and work in 2016 and 2017 to develop exposure drafts, as well as the planned timeline to revise ISA 540 included in the planned December 2015 project proposal]

15. The clarified ISAs and ISQC 1 serve a fundamental role in underpinning audit quality and users' confidence in the audit and financial reporting. It is therefore in the public interest that these standards be as robust as possible with appropriate guidance to support the principles-based requirements, such that they are capable of being implemented consistently and on a global basis.
16. The profile of tomorrow's auditor is that of a critical challenger, supported by a regime focused on public interest and quality management, and whose activities are better observable for stakeholders. The IAASB believes that the ISAs and ISQC 1 need to better address increasing complexity and new technologies in the business and audit environment, and deliver against the public's heightened expectations of audit quality.

17. In its consideration of standard-setting and other activities with respect to the three projects addressed by this consultation, the IAASB will focus on a number of key public interest areas, including:
 - *Enhancing the ISAs to be sufficient and appropriate for the evolving and complex business environment of today and in anticipation of increasing complexity and ongoing evolution into the future* – Do the ISAs contain robust, yet sufficiently flexible, requirements and guidance to drive appropriate auditor performance (including what is expected of the engagement partner) and promote audit quality in the varied and complex scenarios that arise today, and that are likely to continue to evolve in the future? For example, how can improvements be made to the ISAs, particularly ISA 600,⁵ to strengthen the quality of multi-national audits, taking into account challenges that may arise from law, regulation or the impact of factors such as auditor rotation and virtual communication?
 - *Facilitating a proactive Quality Management Approach by firms and their leaders* – What can be done to encourage firms to take a holistic view towards quality in how they lead and manage their businesses, promote a culture of quality throughout their organizations and design and implement the firm's system of quality control? Could a fresh look at the form, structure and requirements in the IAASB's standards addressing quality control have a positive effect on audit quality by promoting and better supporting the design of a firm's system of quality control that is responsive to risks of the firm not meeting its quality objectives?
 - *Networks, Firms, Remediation Processes* – Is there sufficient clarity regarding the linkages between the firm and, where applicable, the network within which it operates, particularly where the firm is placing reliance on network policies and procedures to meet quality control obligations at the engagement and firm levels? Would enhancing requirements on how firms, and the networks within which they operate, internally communicate and respond to internal and external inspection findings positively impact audit quality?
 - *Fostering an independent, challenging, and skeptical mindset of the auditor* – Should the fundamental concept of professional skepticism be better reinforced within the ISAs or through other activities by the IAASB or others and, if so, how? Can the roles and responsibilities of the engagement quality control review and reviewer be enhanced?

⁵ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

- *Communication, Interactions, and Documentation* – Would strengthening the ISAs to enhance interactions and communication, for example between engagement partners and engagement teams and others involved in the audit, or between group engagement teams and component auditors contribute to more effective audits? How might these essential interactions and communications be more appropriately evidenced in an audit file?
- *Transparency and observability* – Could initiatives be undertaken to provide investors and other users of audited financial statements with greater insight into an audit firm's system of quality control (e.g., via transparency reporting by the audit firm) or aspects of individual audits (e.g., through further enhancement to the auditor's report)?

18. The IAASB recognizes that its standards apply to a wide range of circumstances in diverse jurisdictions. Any changes to the standards therefore will need to be drafted with a view towards maintaining the relevance of the standards as the circumstances to which, and in which, they are applied continue to evolve. Such changes will also be made retaining the fundamental principles of an audit and overall objectives of the auditor,⁶ including the application of appropriate professional judgment⁷ and professional skepticism.⁸
19. An important part of this consultation is to seek to obtain input about respondents' understanding of the causal factors of audit deficiencies (in the context of its priority projects). Input from respondents in this regard will help the IAASB determine what it can address and how best to do so effectively. For example, this input will inform the IAASB's efforts to explore what changes to the ISAs and ISQC 1 are needed to enhance auditor performance, as well as its consideration of whether there are other actions by the IAASB that are needed.
20. At the same time, in light of the interactions described in the Framework, others can likely also undertake actions that would complement the IAASB's standard-setting actions (e.g., regulators and audit oversight bodies, audit committees, policymakers, and audit firms). The IAASB therefore welcomes views from its stakeholders about where others can proactively take steps to meaningfully enhance audit quality worldwide.

Questions on public interest matters and possible actions to address them in the context of quality control, group audits and professional skepticism are included on page 18 of this overview. The ITC also includes more detailed questions on specific potential areas for improvements within the IAASB's standards as it relates to quality control and group audits. Accordingly, the detail included in the ITC may also assist respondents in forming a view to the questions included in this overview.

⁶ In conducting an audit of financial statements, the overall objectives of the auditor are: (a) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, and (b) to report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

⁷ Professional judgment is defined in the ISAs as the application of relevant training, knowledge and experience, within the context provided by accounting, auditing and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

⁸ Professional skepticism is defined in the ISAs as an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Strengthening Quality Control Requirements and Guidance

A New Quality Management Approach

21. Some firms, including SMPs, have criticized ISQC 1 as being a “one size fits all” approach to quality control, with little regard to the nature of the firm and the services that it provides.⁹ At the same time, regulators and audit oversight bodies have expressed concern that firms of all sizes are not focused on continually enhancing audit quality – in particular, not sufficiently considering and responding to findings from both external inspections and internal monitoring.
22. The IAASB therefore believes it is necessary, and in the public interest, to take a fresh look at the form, structure and requirements of ISQC 1. Initial IAASB discussions have indicated that redesigning this standard to support a more holistic approach to quality, such as through a quality management approach (or “QMA”), might better facilitate the design and implementation of effective systems of quality control. Revising ISQC 1 in this manner may also lead to changes to ISA 220.¹⁰
23. A QMA would not abandon or lessen the objectives and fundamental requirements that exist in ISQC 1. Rather, a QMA would shift the focus in ISQC 1 to the need for preventative measures (including preventative controls) to meet quality objectives. This is in contrast to the current approach, which some stakeholders view as one of over-reliance on detective and corrective measures. Some of the differences between the approach taken in ISQC 1 and a QMA are illustrated in the table below.

ISQC 1	QMA
Standardized assumptions regarding risks of a firm not meeting its quality objectives and standardized approach to a firm’s system of quality control that may not fit with a firm’s particular circumstances	ISQC 1 would continue to contain minimum requirements, requiring the firm to identify risk(s) of not meeting the firm’s quality objectives, and to design and implement a system of quality control to respond to those identified risks
No explicit sliding scale embodied within requirements	Sliding scale inherent in a quality management system (e.g., addressing requirements would take into account consideration of variations of size of firm, types of services, nature of engagements), which may benefit SMPs
Viewed as largely applicable for audit engagement context – not by less regulated engagements	Holistic approach – Enables the firm to consider its quality objectives not only in the audit context, but also for less regulated engagements (e.g., compilations or agreed-upon procedures)
Fewer conditional requirements compared to other ISAs	Increased use of conditional requirements resulting from focus on a firm’s individual circumstances. For example, in a micro firm environment where a firm has very few staff controls over assignment of staff at the engagement level, those controls may also meet objectives of firm level human resource

⁹ ISQC 1 applies not only to firms that conduct audits of historical financial statements, but also those that conduct review and other assurance engagements, compilation engagements, and agreed-upon procedures engagements.

¹⁰ ISA 220, *Quality Control for an Audit of Financial Statements*

ISQC 1	QMA
	policies and procedures. Currently ISQC 1 does not provide guidance demonstrating that this approach may be acceptable.
Monitoring – focus on internal inspections and peer reviews	Promote the consideration of all feedback on quality, including inspections (internal and external), peer reviews, pre-issuance and post-issuance reviews

24. Similar to the COSO Enterprise Risk Management (ERM) Framework,¹¹ a QMA would facilitate a multi-dimensional view of the firm and its operations, encouraging a more proactive and innovative approach to the design of its system of quality control that has the objective of achieving quality for all the services that the firm provides.
25. In order for the firm to achieve its quality objectives, there are two important elements a firm would follow under a QMA:

(a) Quality Management Foundations

<i>Quality Culture</i>	<i>Quality Strategy</i>	<i>Quality Organization</i>
The quality culture is part of a firm’s overall culture and comprises the mindset, attitudes and behaviors in dealing with quality. It influences the awareness of partners and staff on risks to quality and forms the foundation of an effective quality management system.	The quality strategy defines the quality objectives and the extent of quality risk a firm is willing to take in its different service areas.	Effective operation of the quality management process requires a transparent and clear definition and communication of roles and responsibilities, as well as sufficient and appropriate resources in terms of human capital, policies, methodologies, tools and other guidance.

In defining and setting its quality objectives, the firm would take into account various factors such as:

- The types of services the firm provides or aims to provide in the future. This would include consideration of:
 - Does or will the firm perform audits, reviews and compilations and other related services, or only one or a combination of these?
 - Does or will the firm perform such services for listed entities, public interest entities (PIEs), non-listed entities (including small and medium-sized entities (SMEs) and micro-entities) or only one or a combination of these? Are those services performed for entities in particular industries or jurisdictions?

¹¹ The Enterprise Risk Management—Integrated Framework (2004) issued by the *Committee of Sponsoring Organizations* of the Treadway Commission (COSO ERM Framework). COSO’s ERM Framework is widely accepted and used by entities globally to enhance an organization’s ability to manage uncertainty, consider how much risk to accept, and improve understanding of opportunities as the organization strives to increase and preserve stakeholder value. The COSO ERM Framework is in the process of being updated to make it more relevant in the increasingly complex business environment. COSO expects to publish an exposure draft for public comment in the first quarter of 2016.

- Its relevant stakeholders (such as users, preparers, audit committees) and understanding their expectations of quality, in relation to the services the firm is providing, including the regulatory regime in which the firm and the entities to which it provides services operate (e.g., whether there is an independent audit inspection regime).

(b) Quality Management Process



Building on its Quality Management Foundations, the firm would follow a Quality Management Process to design and implement the policies and procedures to assist the firm in meeting its quality objectives.

<i>Elements of the Quality Management Process</i>	<i>Relevant Activities</i>
Quality risk assessment / Identification of quality risks	<ul style="list-style-type: none"> • A structured approach to identifying those events and conditions that may have a material effect on the firm’s ability to achieve the quality objectives • Identified quality risks are analyzed for probability of occurrence and potential consequences. The risk assessment should be sufficiently detailed to serve as a basis for designing and implementing quality control responses and activities.
Design and implement responses to quality risks	For each of the (aggregated) assessed quality risks, the firm determines appropriate responses to identified quality risks, designed to avoid, reduce, share, transfer or accept risks. The quality strategy serves as a framework for these decisions, which may result in the development and implementation of policies and procedures.

Implement quality control activities	Implement quality control activities to provide reasonable assurance that policies and procedures designed to address risks of the firm not meeting its quality objectives are operating effectively.
Inform, communicate and document	Identification, capture, and communication of relevant quality risk information in a format and time frame that enables people to carry out their responsibilities; communication includes providing timely and relevant information to firm’s leadership.
Quality monitoring	The design and operating effectiveness of the quality management process are monitored through both integrated and distinct monitoring activities, which include external inspections and other reviews (such as peer reviews, pre-issuance and post-issuance reviews). Monitoring findings are communicated to the firm’s leadership and the appropriate management levels and analyzed as a basis for continuous improvement of the quality management process.

In assessing risks of not achieving the established quality objectives, the firm would identify risk factors that exist that may affect the firm’s ability to meet its quality objectives. This risk identification is performed in the context of both the entities for which engagements are undertaken and the types of those engagements. These risk factors may include:

- External factors, such as:
 - The nature of the industry that those entities operate in (e.g., highly regulated, complex financial arrangements, sole proprietor entity, family owned business);
 - The overall financial condition / position of the industry and the individual entities for which engagements are undertaken within that industry; and
 - Whether the type of work or industry requires specific or specialized expertise and whether that expertise is readily available.
- Internal factors, such as:
 - Assessing qualifications, experience, skills and knowledge of the firm’s work force;
 - The potential effect of staff turnover (i.e., reliance on certain staff and risk that if these staff left the firm, quality would be impacted); and
 - Resource availability to staff engagements, including cooperation and sharing of resources within the firm, and prioritization of work importance when certain individuals perform services for audit as well as other engagements.

26. A QMA may facilitate the integration of a firm’s system of quality control into other aspects of its management structures and business processes. For example, integration of the firm’s system of quality control with corporate governance systems and risk and compliance management systems and more robust processes to understanding (“root cause analysis”) and responding (remediation) to internal and external inspection findings at both an engagement and firm level.
27. The IAASB must respond to issues identified with the current quality control requirements in ISQC 1 – not only that they are viewed as being challenging to implement, but also that they are not leading to high-quality audits. A QMA represents, in the Board’s view, a meaningful public interest solution to

these different yet related concerns. At the core of the IAASB's efforts in this regard will be consideration of the nature and sufficiency of the current requirements and guidance in ISQC 1, (without lessening them), and supplementing those requirements where necessary in the public interest to respond to issues identified, adapting and integrating the requirements into a more holistic approach to quality under a QMA.

Specific Issues to Be Addressed at the Firm and Engagement Level in Revising the Quality Control Standards

28. The IAASB's deliberations to date have focused on many aspects of a firm's system of quality control that are essential to the performance of quality audits, and have noted that certain aspects could be enhanced or more explicitly addressed in ISQC 1 and ISA 220.
29. In addition to considering incorporating a QMA to the system of quality control at the firm level into existing requirements, it is in the public interest that the roles and responsibilities of both the firm and the engagement partner are robust and clearly articulated within the IAASB's standards. It is also fundamental that the basis for reliance on a firm's system of quality control at the engagement level and, where applicable, the reliance on network level policies and procedures by the firm within its system of quality control is set forth clearly. Reinforcing and improving these foundational elements upon which audits are conducted will help to facilitate the ongoing effective implementation of the principles-based ISAs and ISQC 1, in particular as the environment changes and challenges continue to emerge.

Firm Level: Monitoring and Remediation

30. Since ISQC 1 was developed, the nature and extent of audit regulation has expanded in many jurisdictions around the world, and therefore external inspections and related findings are far more prevalent today. Audit regulators expect firms to take appropriate actions to investigate and understand the causal factors of inspection findings across all levels (i.e., engagement, firm and network where applicable) as the basis for determining remediation activities and assessing their effectiveness. The IAASB is therefore considering enhancements to strengthen ISQC 1 to require policies and procedures to emphasize actions to be taken by an audit firm to respond to inspection findings, as part of accountability of firm leadership for sustaining and continuously improving audit quality (i.e., "tone at the top"). As noted in the description of a QMA, promoting the consideration by the audit firm of *all* feedback on quality is essential. This includes considering the results of inspections (internal and external), peer reviews, pre-issuance and post-issuance reviews, supported by actions necessary to respond and monitoring the effectiveness of those actions to determine whether more is needed.

Firm Level: Quality Control Policies and Procedures When Operating through a Network of Firms

31. ISQC 1 is directed at the individual firm level, not the network level. The nature and extent of the policies and procedures developed by an individual firm to comply with ISQC 1 will depend on various factors such as the size and operating characteristics of the firm, including whether it is part of a network or alliance, and the nature of the network, or alliance, arrangement. Individual audit firms that operate through a network or alliance 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 or alliance's system of quality control, including monitoring policies and procedures, in addressing

certain of the individual audit firm's responsibilities under ISQC 1 (recognizing that not all may choose to do so).

32. The IAASB's current standards do not establish any requirements at the network level nor do they address the possibility of such reliance on network or alliance level policies and procedures in any significant detail. It is therefore in the public interest that the IAASB consider the need for clarity in ISQC 1 and ISA 220 about what should be considered and documented by the individual audit firm as a basis for reliance on network or alliance level policies and procedures, i.e., to safeguard against undue reliance without sufficient consideration by the firm of the appropriateness of doing so. Importantly, further work by the IAASB in this area will need to take into account the fact that:
- Networks or alliances may be structured differently and with differing nature and extent of common policies and procedures; and
 - Such structures may be highly influenced by law and regulation in the various jurisdictions in which the network or alliances and individual audit firm(s) are established.

Firm Level: Transparency Reporting

33. There is an increasing trend of firms issuing reports that provide transparency regarding certain elements of the firm and its operations, also referred to as transparency reports. This reporting is taking place either because it is required by law or regulation, or because firms are choosing to issue such reports on a voluntary basis. However, current practices and the requirements for such reporting vary significantly between jurisdictions,¹² and may involve reporting on matters beyond the audit firm's system of quality control or other areas addressed by the IAASB's International Standards. Global organizations like IOSCO are interested in the topic and likely have the ability to influence a globally accepted form of, or requirements for, transparency reporting or common elements therein.
34. The IAASB believes it should seek to understand the demand and requirements for transparency reporting around the world, and how such reports are being used by investors, regulators and others. Doing so will enable the IAASB in understanding whether establishing requirements to address elements of transparency reporting – for example, requiring firms to provide greater insight into their system of quality control (designed in accordance with ISQC 1) and its effectiveness – could be feasible on a global basis, and if so, how that might be done.

Engagement Level: Engagement Partner Roles and Responsibilities

35. The engagement partner responsible for each individual audit engagement plays an essential role relative to audit quality, and is responsible for the quality of the engagement and its performance. While ISA 220 allows for the engagement partner to rely on certain aspects of the firm's system of

¹² Transparency reports are required in the European Union for audit firms that carry out statutory audit(s) of PIEs. These reports are required to include at least (i) information related to the legal structure and ownership of the audit firm; (ii) a description of the network the audit firm belongs to (if applicable); (iii) governance structure of the audit firm; (iv) a description of the audit firm's internal quality control system; (v) an indication of when the last quality assurance review took place; (vi) a list of PIEs for which the audit firm has carried out statutory audits during the preceding financial year; (vii) a statement regarding the audit firm's independence practices; (viii) the continuing professional education policy of auditors within the audit firm; (ix) audit firm financial information; and (x) information on basis for partner compensation. Transparency reports are also required or more commonly used in Australia, Japan and Turkey and are being considered elsewhere.

quality control, the importance of a strong quality mindset by the engagement partner cannot be underestimated.

36. The IAASB believes that there are opportunities to strengthen the requirements in the ISAs for the engagement partner in relation to demonstrating appropriate direction and supervision throughout the audit. In particular, concerns have been expressed by audit oversight bodies and others about how the requirements of ISA 220 are addressed today in situations where:
- Other auditors are involved in an engagement that is not an audit of group financial statements (and to which ISA 600 does not apply).¹³ The involvement of other auditors may be a function of how an entity is structured (e.g., domiciled in one jurisdiction, but with operations in another), or the circumstances of a particular audit, but can also be driven by how a firm assembles the engagement team (including potentially through the use of one or more ADMs). Consideration will therefore be given to how the engagement team assesses the sufficiency and appropriateness of the work of any other auditors involved in the audit, including considering their professional competence and capabilities. The IAASB will also consider the effects on audit quality of ADMs more broadly, including consideration of how the firm's system of quality control should be applied and how work is being directed, performed, supervised and reviewed.
 - There are challenges for the engagement partner because of complex structures or multi-location (group) audits, including in relation to how the role of the engagement partner is formally defined in the ISAs. While ISA 600 provides specific considerations for auditors when auditing group financial statements, concern has been expressed that this ISA does not contain sufficient guidance or direction for particular circumstances that arise in group audits (such as non-controlled components, the entity's use of shared service centers). In addition to revisiting the requirements in ISA 600, these concerns suggest a greater focus may be needed in ISA 220 in relation to the core requirement for the engagement partner to take responsibility for (i) the direction, supervision and performance of the audit; (ii) the auditor's report being appropriate in the circumstances; and (iii) appropriate reviews being performed.
 - It is not clear how the engagement partner is satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. For example, concern has been expressed about the nature and extent of audit evidence obtained in relation to significant management judgments, as well as how auditor's experts are being used in relation to key areas, such as fair value accounting estimates (including whether reliance on this work is appropriate).

Firm and Engagement Level: Engagement Quality Control Reviews and Engagement Quality Control Reviewers

37. As a complement to the requirements set forth for engagement partners, ISQC 1 and ISA 220 set out requirements for firms to establish policies for audits of financial statements of listed entities to have an engagement quality control (EQC) review conducted by an EQC reviewer.¹⁴ EQC reviews are intended to involve objective evaluations of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. The performance of an effective EQC

¹³ While ISA 600 contains requirements and guidance to address the involvement of component auditors in a group audit situation, the ISAs do not include specific requirements and guidance to address the involvement of other auditors in non-group situations.

¹⁴ ISQC 1 also requires firms to establish criteria to determine when other engagements should be subject to an EQC review.

review is an important engagement level quality control, but also a key aspect of the monitoring component of a firm's system of quality control, and therefore serves as an important preventative control.

38. The IAASB recognizes the importance of the EQC review and the public interest importance ascribed to it by certain stakeholders. However, concerns have been raised about whether EQC reviews are being performed as intended, for example, about whether appropriate individuals are being selected to perform the review, as well as about the effectiveness of the reviews themselves. Questions have also been raised as to whether the requirements and guidance in the IAASB's standards need to be clarified or strengthened, including whether the requirement to have an EQC review should be potentially expanded beyond audits of listed entities.
39. The IAASB is exploring whether strengthening the requirements for EQC reviews and EQC reviewers may be useful to enhance audit quality, for example by:
 - Further specifying the nature and extent of matters to be considered by the EQC reviewer and how this review is to be documented.
 - Requiring the engagement quality control reviewer to communicate directly with the audit committee in certain circumstances.
 - Providing transparency in the auditor's report that the engagement was subject to an EQC review.
40. The IAASB is also considering whether it might be appropriate to make the EQC review more prominent by moving the requirements and guidance for an EQC review into a separate standard (i.e., moving them out of ISQC 1 and ISA 220).¹⁵

¹⁵ In the US, the PCAOB has a separate auditing standard for EQC review, Auditing Standard No. 7 (AS 7), *Engagement Quality Review*.

The Need for an Enhanced Standard Addressing Group Audits

41. As the business environment evolves and becomes increasingly complex, it poses challenges not only for auditors, but also for preparers and those charged with governance (e.g., audit committee members) preparing or overseeing the preparation of high-quality financial statements, including related disclosures.
42. In particular, many audits today are audits of group financial statements and therefore involve participation of component auditors who perform work on financial information related to other components in the group. Component auditors may operate in jurisdictions with different cultures and languages, law or regulation (which may impact access to necessary information or working papers, as well as different independence and ethical requirements), and financial reporting and auditing requirements.
43. In addition to the challenges that these matters bring into group audits, there are new and continuing practical challenges as entities' structures become more complex and continue to evolve. Auditors structure their audit engagements to respond to such practical challenges, including when such audits are group audits as defined in the ISAs. Situations where challenges arise include where:
 - Access by the group engagement team to the relevant financial information of components is restricted, and communication may be restricted. More broadly, concerns have been noted in practice about difficulties in obtaining access to non-controlled entities (e.g., when the entity accounts for particular investments using the equity method of accounting), which may or may not be considered components.
 - The group engagement team has structured the audit engagement team to use ADMs and other evolving audit practices that are not well addressed throughout the ISAs, including, for example, where there is increased use by entities of shared service centers (SSC), which may perform financial reporting or accounting functions for some or all components within a group. The group engagement team may use component auditors to perform procedures at the SSC, and various questions about how to apply the ISAs in these situations have arisen.
 - The engagement partner is not located where the majority of the audit work is performed.
 - The impact of mandatory auditor rotation in some jurisdictions on the group audit.

The IAASB therefore intends to consider clarified or strengthened requirements in ISA 600, as well as additional practical guidance, to enhance the quality of audits of group financial statements, and changes to other ISAs as needed.

44. In considering changes to the ISAs, the IAASB needs to take into account that group structures are unique. As such, the relevant ISAs need to continue to be principles-based and capable of being applied as such structures continue to evolve, and allow the auditor to structure the audit engagement to respond to such practical challenges. This consideration will also take into account the role of ISA 220 as the overarching ISA addressing quality control at the engagement level.
45. At the same time, any changes to the ISAs also need to acknowledge that work of others may often be used as evidence to support the opinion on the financial statements. The IAASB will therefore also explore whether greater transparency in the auditor's report about the involvement of others in the audit may be beneficial, including component auditors, other auditors and auditor's experts, including the nature and extent of such involvement.

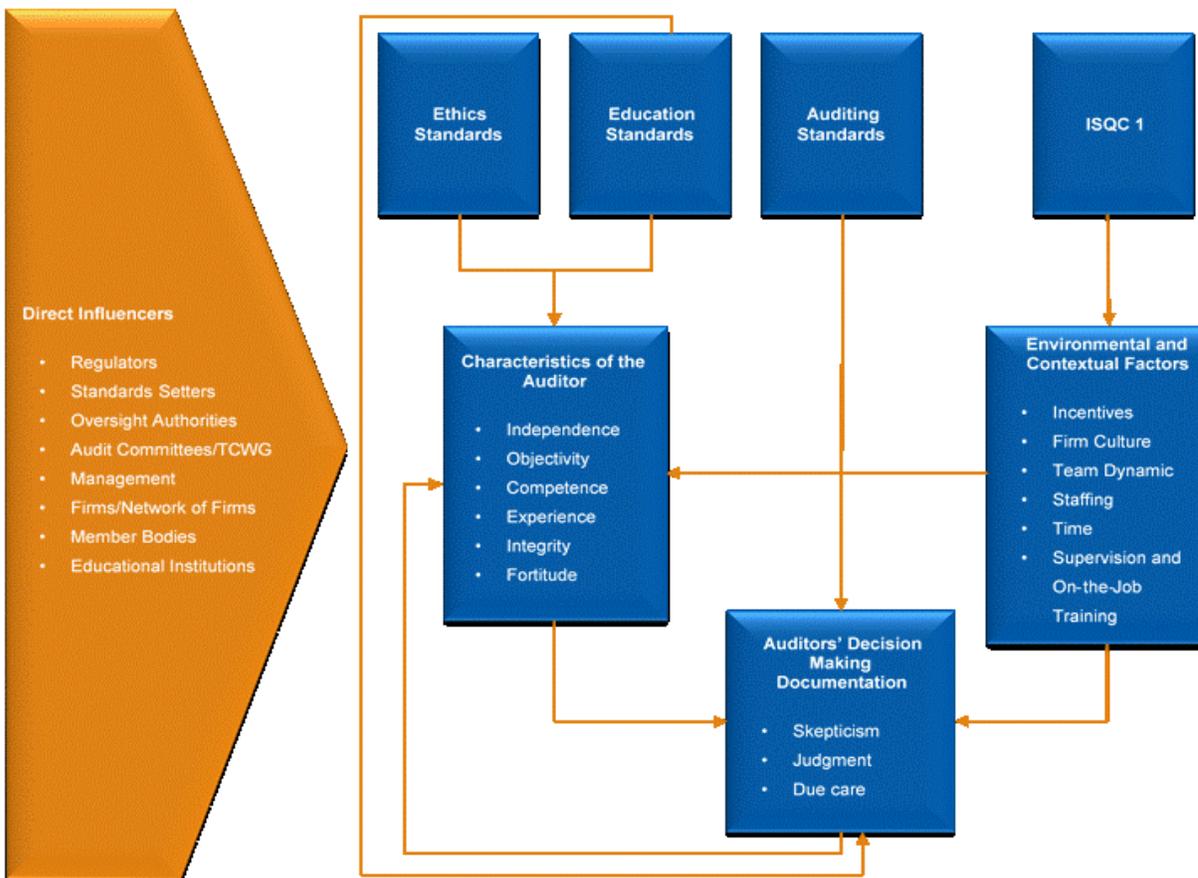
Strengthening Professional Skepticism in the Audit

46. Other essential elements supporting the foundation of a quality audit include professional judgment and professional skepticism, appropriately documented in the audit file. The ISAs require the auditor to exercise professional judgment and professional skepticism throughout the planning and performance of the audit. Reasonable judgments are achieved when the auditor has developed the necessary competence through training, knowledge and experience, and are made in light of the facts and circumstances. Professional skepticism is necessary to the critical assessment of audit evidence.

47. The topic of professional skepticism is multi-faceted, as it relates to:

- Independence of mind and integrity, with linkages to firm culture, governance and incentives.
- Objectivity, as it addresses cognitive biases.
- Due care, for example where auditor reliance is placed on inquiry or corroboration, as compared to obtaining and evaluating conflicting evidence.
- Skills and experience, so training and education, as well as exposure, are necessary to cultivate an individual's ability to appropriately exercise professional skepticism.

The diagram below depicts the IAASB's preliminary thoughts about interactions and contextual factors in relation to professional skepticism.



48. Though most prominently dealt with in the ISAs, professional skepticism is also addressed in the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code)¹⁶ and the International Accounting Education Standards Board (IAESB) standards.¹⁷ Because of this, a joint Working Group has been formed with representatives from these three independent standard-setting boards (SSBs) to start the exploratory work and make recommendations to each Board whether there is standard-setting or related work that can be undertaken.
49. Professional skepticism is an important component of many, if not all, of the IAASB's individual projects. For example, the IAASB has acknowledged that its work in relation to ISA 540 provides an opportunity to stress the importance of professional skepticism and professional judgment, as accounting estimates that have been identified as having high estimation uncertainty generally involve significant management judgment and the possibility for unintentional or intentional management bias. In this regard, consideration could be given as to how the requirements are drafted, focusing on a more questioning mindset rather than one of corroboration. Similarly, the Board's planned efforts in relation to its other key projects that have commenced (including those covered by the ITC) and other planned projects (such as to address issues identified relating to ISA 315 (Revised)¹⁸), may also identify areas where further emphasis could be useful on the need for professional skepticism in enhancing and strengthening the standards.

¹⁶ The IESBA Code explicitly mentions the term professional skepticism in a number of places including in the definition of "independence" – both independence of mind, and independence in appearance. There is also a perceived connection between professional skepticism and the fundamental principle of objectivity and integrity, though there is not an explicit reference.

¹⁷ International Education Standards (IES) 4, *Initial Professional Development – Professional Values, Ethics, and Attitudes*, prescribes learning outcomes that aspiring professional accountants should achieve in developing professional skepticism and professional judgment. IES 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements*, prescribes the learning outcomes for professional skepticism and professional judgment that engagement partners are expected to develop and maintain through continuing professional development. Both standards emphasize that effective development of professional skepticism needs to include learning methods such as mentoring, reflective activity, and practical experience within the context of a work environment.

¹⁸ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Questions

1. In your view, do you believe the public interest issues outlined in paragraph 17 are the most relevant issues the IAASB should address? If not, why not?
2. In the context of quality control and a project to revise ISQC 1 and ISA 220:
 - (a) Would you support the IAASB pursuing a QMA? If not, why not? Are there other elements that you think should be explicitly included in such an approach in light of its objective (as outlined in paragraphs 21–27)?
 - (b) What other actions do you think would be most meaningful for the IAASB to take to address the issues highlighted in this overview? Where you believe actions relating to quality control beyond those discussed in this consultation should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.
3. In the context of group audits and a project to revise ISA 600, what actions do you think would be most meaningful for the IAASB to take to address the issues highlighted in this overview and the detailed ITC? Where you believe actions relating to group audits beyond those discussed in this consultation should be prioritized, it would be helpful to understand what those actions are as well as your supporting rationale.
4. In the context of professional skepticism, what actions do you think would be most meaningful for the IAASB (or others) to take to strengthen the application of professional skepticism in audits?
5. Are there other actions not specific to the topics of quality control, group audits and professional skepticism that need to be undertaken by the IAASB (or others) to address the public interest issues outlined in paragraph 17 or threats to audit quality more broadly? If yes, what are they and how should they be prioritized?