

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

## An Overview of the IAASB's Invitation to Comment

### About the IAASB

The IAASB serves the public interest by setting global auditing standards – International Standards on Auditing (ISAs) – in accordance with a robust [due process](#), thereby promoting high-quality audits. Across all parts of the world, [111 countries](#) currently use the IAASB's 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.

### Purpose of 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 professional skepticism, quality control, and group audits. This consultation is being performed at the preliminary stage of the work on these topics. The IAASB has learned that early consultation on directional issues and public interest matters to be addressed and obtaining a robust understanding of the views and expectations of different stakeholder groups facilitates more effective standard setting.

### Objective of this Paper and the Intended Audience

This *Overview of the Invitation to Comment (ITC)* (Overview) is specifically designed to introduce the matters that the more detailed consultation addresses. In particular, the IAASB hopes that this overview will facilitate responses from users and preparers of financial statements, as well as audit committees and their representative organizations. This overview addresses the most important public interest issues the IAASB is seeking to address in the context of its three important topics – [professional skepticism](#), [quality control](#) and [group audits](#).

The separate ITC, *Enhancing Audit Quality in the Public Interest—A Focus on Professional Skepticism, Quality Control and Group Audits*, is a more detailed discussion document, providing greater and more technical details on how the IAASB's standards currently address specific matters related to these topics. In addition to identifying concerns that have been noted related to these matters, the ITC describes possible responsive actions the IAASB may undertake, including identifying specific potential areas for improvements within the IAASB's standards, under the overarching objective of enhancing audit quality. This Overview includes references to the ITC where more details about the matters described in this document may be found. In describing possible actions, the IAASB is not limiting its consideration of other actions that may be more effective, or appropriate.

[All stakeholders are welcome to respond to either this Overview, the ITC or a combination thereof.](#) This Overview contains various questions for respondents. The ITC includes more specific questions and is generally intended to facilitate responses from firms, regulators and audit inspection bodies, national standard setters (NSS), member bodies and others interested in the more detailed aspects of the consultation. If responding to the questions in the ITC, it is not necessary to also respond to the questions in this Overview.

### Being Heard

- To provide input, submit a response by May [X], 2016 (all responses will be made available on the IAASB's website)
- Initiate or attend an event in your jurisdiction where matters relevant to this consultation will be discussed
- For more information, visit [www.iaasb.org/audit-quality](http://www.iaasb.org/audit-quality).

### Questions for Respondents

Questions on which the IAASB is seeking input can be found on page 25.

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## Introduction

1. 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 form the basis for high-quality, valuable and relevant audits, with appropriate guidance to support the principles-based requirements, such that they are capable of being implemented consistently and on a global basis. The IAASB recognizes the importance of being aware as to whether its public interest objectives are being achieved and is committed to proactively seeking relevant information through ongoing outreach activities and periodic post-implementation reviews.
2. The finalization of the IAASB's efforts to clarify the ISAs and International Standard on Quality Control, ISQC, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, was an important step in the IAASB's commitment to audit quality. Shortly after the clarified ISAs became effective in 2009, the Board embarked on its first post-implementation review (the "ISA Implementation Monitoring" project) that was completed in July 2013.

**[PLACEHOLDER FOR PICTURE]**

<b>IAASB's ISA Implementation Monitoring project</b>	<b>Ongoing Outreach</b>
<p>The July 2013 <a href="#">findings from the ISA Implementation Monitoring project</a> indicated the need for improvement to aspects of certain ISAs to achieve greater consistency and effectiveness in their application. These findings were informed by firms', NSS and member bodies' experiences with implementing the clarified ISAs.</p>	<p>The IAASB's rigorous outreach program, in particular its collaboration with audit inspection bodies and regulators, as well as ongoing dialogue with firms, NSS and others, continues to keep the IAASB apprised of areas where improvements to its standards may be needed, or where other actions to enhance auditor performance may be appropriate.</p>
	
<p>Public consultation on IAASB's Strategy for 2015–2019 and Work Plan for 2015–2016</p>	
	
<p>IAASB's <a href="#">Strategy for 2015–2019</a> (Strategy)</p> <p>The IAASB's Strategy sets out three strategic objectives, with the first and most important strategic objective being <b><i>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.</i></b></p>	
<p>IAASB's <a href="#">Work Plan for 2015–2016</a> ("the Work Plan")</p> <p>The IAASB's public consultation on its current Work Plan highlighted its commitment to addressing significant findings from the ISA Implementation Monitoring project on a timely basis. Stakeholders responding to that consultation urged the IAASB to do so as a matter of public interest, and their input formed the basis for the IAASB's determination as to which projects to include in the current Work Plan. With the strategic objectives in mind, the Work Plan gave priority to:</p> <ul style="list-style-type: none"> <li>• Quality control;</li> <li>• Group audits;</li> <li>• Professional skepticism; and</li> <li>• Special considerations in audits of financial institutions (including a potential revision of ISA 540).<sup>1</sup></li> </ul>	

<sup>1</sup> The financial institutions project is not directly addressed by this consultation. At its December 2015 meeting, the IAASB [approved] a project proposal to revise ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

## Taking Action in the Public Interest

3. In its consideration of the three projects addressed by this consultation (i.e., professional skepticism, quality control and group audits), the IAASB is focused on taking action in the public interest. In identifying the important matters to be addressed, and in framing the related issues, the possible standard-setting and other activities described in this consultation, the IAASB has considered various questions. The matters identified and the questions considered include:
- *Enhancing the ISAs to be 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 the role and responsibilities 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,<sup>2</sup> 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 the use of audit delivery models (ADMs)?
  - *Facilitating firm leaders taking responsibility for implementing a proactive approach to quality management* – What can be done to encourage firms to take a broader approach toward managing quality, including in terms of how leadership of the firm proactively leads and manages their businesses, promoting a culture of quality throughout their organizations and continuous improvement to quality through effective monitoring and remediation? Could a fresh look at the form, structure and requirements in the IAASB's standards addressing the firm's system of quality control have a positive effect on audit quality by promoting and better supporting the design of a firm's approach to quality management that is responsive to risks of the firm not meeting its quality objectives? Should the scope of required engagement quality control reviews be expanded (i.e., beyond listed entities) and should the roles and responsibilities of the engagement quality control reviewer be enhanced?
  - *Networks, Firms, Remediation Processes* – Is there sufficient clarity regarding the linkages between a firm and, where applicable, the network within which it operates, particularly as to what is needed when the firm is placing reliance on network policies and procedures to meet quality control obligations at the engagement and firm levels? Would enhancing requirements as to how firms, and the networks within which they operate, communicate internally and how they respond to internal and external inspection findings positively impact audit quality?
  - *Fostering an independent, challenging, and skeptical mindset of the auditor* – Can 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 responsibilities of the engagement partner in this regard – as the champion for audit quality – be further enhanced?
  - *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 explore how investors and other users of audited financial statements might be provided with greater insight into a firm's system of quality control (e.g., in acknowledgement of the developments in firm-level transparency reporting)?

*Note: Although this consultation includes specific questions for respondents to consider in providing input on this consultation, the above questions used by the IAASB in framing the issues may help respondents in formulating or informing their views.*

<sup>2</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

4. The IAASB recognizes that its standards apply to a wide range of circumstances in diverse jurisdictions and that the circumstances in which they are applied continue to evolve. Any changes to the standards will therefore need to be made in the context of maintaining their ongoing relevance, while retaining the fundamental principles of an audit and overall objectives of the auditor,<sup>3</sup> including the application of appropriate professional judgment and professional skepticism.
5. An important part of this consultation is to seek to obtain input about respondents' understanding of the causal factors of issues (including inspection findings) related to the priority projects, and in the context of that understanding, solicit views about potential improvements to the related standards that might be necessary. Relevant input from respondents will help the IAASB determine what issues it can address and how best to do so. For example, this input will inform the IAASB's efforts to explore potential changes to the ISAs and ISQC 1 to enhance auditor performance, as well as its consideration of whether there are other actions by the IAASB that would be appropriate and effective.
6. At the same time the IAASB notes that there are others that can likely also undertake actions that would complement its standard-setting actions (e.g., regulators and audit oversight bodies, audit committees, policymakers, NSS, member bodies or firms) in relation to the three topics of professional skepticism, quality control and group audits. The IAASB therefore welcomes views from its stakeholders about where others can proactively take steps to meaningfully enhance audit quality in relation to these topics. The IAASB believes that facilitating cooperation and interaction among its stakeholders on matters related to enhancing audit quality is an important part of its remit as a global standard setter.
7. It is expected that input from respondents will form the basis for project proposals relating to quality control and group audits. After these project proposals for standard-setting activities are approved by the IAASB, the relevant Task Forces will commence work to developing changes to the ISAs and ISQC 1. Expected actions in relation to the professional skepticism project are further explained in paragraphs 17-34
8. The expected timeline for the projects on quality control and group audits is as follows:



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<sup>3</sup> 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.

## Audit Quality: The Interaction 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.

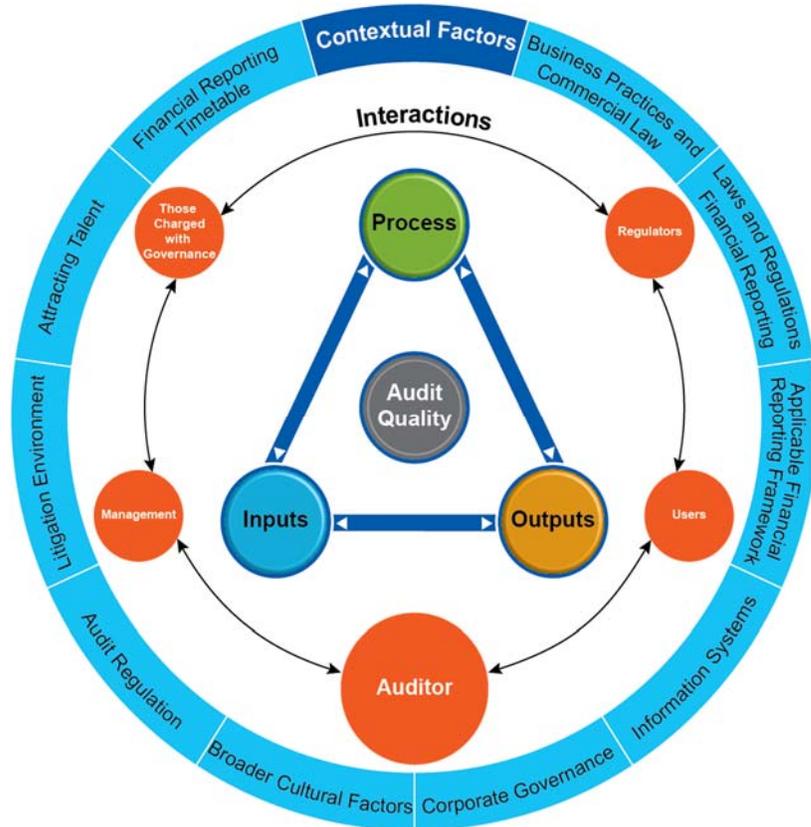
A **quality audit** is likely to have been achieved by an engagement team that:

- ❖ 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)

9. The IAASB's [Framework for Audit Quality](#) (the AQ Framework) was developed to raise awareness of the key elements of audit quality, encourage stakeholders to explore ways to improve audit quality, and facilitate dialogue between key stakeholders<sup>4</sup> on the topic. The AQ Framework also highlights important inputs, processes and outputs—with quality audits involving auditors applying rigorous processes and quality control procedures that comply with law, regulation and applicable standards.

10. The AQ Framework also highlights that responsibility for performing quality audits of financial statements rests with auditors.



<sup>4</sup> In the graphic, "those charged with governance" refers to those who have responsibility for overseeing 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, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.

The primary output of an audit is an auditor's opinion that provides users with confidence as to the reliability of the audited financial statements. For the majority of users, the absence of a modified auditor's opinion is an important signal about the reliability of the financial information.

- Paragraph 20 of the AQ Framework

Audits need to be performed in accordance with auditing standards and are subject to the firm's quality control procedures, which comply with ISQC 1. These provide the foundation for a disciplined approach to risk assessment, planning, performing audit procedures and ultimately forming and expressing an opinion. Sometimes, firms' methodologies and internal policies and procedures provide more specific guidance on matters such as who undertakes specific activities, internal consultation requirements, and documentation formats.

- Paragraph 12 of the AQ Framework

11. In recent years, audit oversight bodies have intensified inspection and other activities, including their level of coordination on an international basis. Publicly reported inspection findings consistently highlight aspects of the audit where improvements to audit quality are needed. For example, the International Forum of Independent Audit Regulators' (IFIAR) [2014 Summary of Inspection Findings](#) highlights IFIAR's view of persistent deficiencies in important aspects of audits, including with respect to firms' systems of quality control, quality control at the engagement level, performance of group audits and application of professional skepticism. The themes from external inspections as communicated by regulators and audit oversight bodies are largely consistent with what the IAASB has learned from its ISA Implementation Monitoring project in terms of where specific standards could be enhanced to drive improved audit quality. Therefore, enhancing the standards in these areas may also help improve auditor performance and result in reduced levels of inspection findings.
12. Regulators and audit oversight bodies have also highlighted concerns related to the auditing of accounting estimates (including fair value measurements), including noting instances where auditors do not appear to have applied the necessary professional skepticism. These stakeholders are calling for more robust requirements in the ISAs to direct how the auditor is expected to obtain sufficient appropriate audit evidence in relation to accounting estimates, including more granularity relating to the evaluation of management's assumptions and consideration of indicators of management bias. The IAASB's project to revise ISA 540 will consider these issues.<sup>5</sup>
13. The IAASB also recognizes that broader environmental factors – referred to in the AQ Framework as “contextual factors” – have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality. As countries develop and, in particular as businesses grow in size and need to obtain finance from capital markets, the environment becomes more complex. Financial reporting is very important to decision-making and user expectations as to its reliability remain high. In response, law, regulation, financial reporting requirements and corporate governance processes continue to develop and adapt. The evolving business environment and increasing complexity poses challenges for preparers and those charged with governance (e.g., audit committee members) who are responsible for preparing or overseeing the preparation of high-quality financial statements, including related disclosures. Concomitant challenges also arise for auditors.

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<sup>5</sup> The IAASB has commenced work to consider the potential need for strengthened requirements and enhanced guidance for auditors as it relates to auditing accounting estimates in light of developments in financial reporting standards, and actions necessary to address issues specific to audits of financial institutions

14. As the environment in which financial reporting and auditing takes place continues to evolve, it is necessary for the IAASB to be mindful of these contextual factors in its standard-setting activities, to ensure that the ISAs are, and remain, “fit for purpose.” Of particular relevance to the IAASB are the following contextual factors and related developments:
- *Business practices and commercial law* – Law or regulation may create tax or other incentives based on how and where entities are domiciled, which may influence how entities are structured. Entities are also increasingly using shared service centers to improve effectiveness and enhance the efficiencies of their operations.
  - *Laws or regulations relating to financial reporting and the applicable financial reporting framework* – Financial reporting frameworks are increasingly requiring significant management judgment and relying more on forward-looking information as the basis for recognition or measurement or as information to be disclosed in the financial statements.
  - *Information systems* – Businesses are becoming dependent on complex systems and the sophisticated underlying technologies, with an increasing focus on “big data.” Audits are also increasingly being conducted using advanced technologies (including the evolving use of audit data analytics).
  - *Corporate governance* – In recognition of their important role in enhancing audit quality, audit committees are being called on to become stronger and more active;<sup>6</sup> not only with regard to their interactions with auditors, but also as it relates to their responsibilities for oversight of the financial reporting process
  - *Audit regulation* – Increasingly, law or regulation provide that inspections of audits of listed entities be undertaken by independent audit regulatory bodies. Audit inspections provide an important mechanism for evaluating auditors’ compliance with auditing standards and, depending on the mandate, other aspects of audit quality. Actions taken by firms to address weaknesses identified through inspections have the objective of improving audit quality.
  - *Attracting talent* – Auditing is a demanding intellectual activity requiring the application of good judgment, an inquiring mind, and considerable business, financial reporting and auditing knowledge. 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”). As a result, firms are contemplating their own structures and how best to organize engagement teams and conduct audits, with a view towards involving appropriately skilled and competent people to perform high-quality audits at a reasonable cost. Members of an audit engagement team may no longer all be located in the same place (which, historically, has been the traditional audit model); rather, members may now be in different jurisdictions or time zones. The IAASB refers to these evolving models as ADMs, a term that is intended to encompass terms such as “firm shared service centers,” “centers of excellence,” “on-shoring,” “offshoring,” or “outsourcing.”

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<sup>6</sup> 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).

15. Some firms have also highlighted the need, in some cases, for the development of firm guidance to bridge perceived gaps or difficulties in applying the ISAs and ISQC 1 to circumstances not specifically addressed in the standards. Concerns were (and 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 audits of smaller or less complex entities.
16. The profile of tomorrow's auditor is that of a critical challenger, supported by a regime focused on public interest and quality management. In order to achieve the IAASB's strategic objective related to the global use of ISAs and in order to continue to deliver against the public's expectations of audit quality and of the role of auditors, the IAASB believes that the ISAs and ISQC 1 need to better address the matters set out in paragraph 3 above, in particular increasing complexity and use of new technologies in both the business and audit environment. The following sections relating to Professional Skepticism, Quality Control and Group Audits set out the IAASB's thinking about how this might be approached.

### Strengthening Professional Skepticism in the Audit

ITC Paragraphs X-X

17. In planning and performing audits, a mindset that includes professional skepticism is necessary in order for auditors to remain cognizant of circumstances that may cause the

#### **Professional Skepticism**

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.<sup>7</sup>

financial statements to be materially misstated. Accordingly, professional skepticism is necessary to the critical assessment of audit evidence. Unless auditors are prepared to challenge management's assertions (including when management has used an expert to assist in preparing financial statements), they will not be able to conclude, with confidence, whether an entity's financial statements are fairly presented in accordance with the applicable financial reporting framework.

18. Also essential to the auditor's decision making and the overall conduct of an audit is the concept of professional judgment. Professional judgment (which is required by the ISAs to plan and perform audits) is the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.<sup>8</sup> The concepts of professional skepticism and professional judgment are closely related, and together are key inputs to audit quality. Professional skepticism facilitates the appropriate exercise of professional judgment by the auditor. Similarly, the exercise of professional skepticism is subject to professional judgment.
19. Like other concepts fundamental to auditing, the topic of professional skepticism is multi-faceted, and is impacted, or is perceived to be impacted by, other related concepts such as:
  - Independence of mind and integrity, with linkages to firm culture, governance and incentives.
  - Objectivity, as it addresses cognitive biases.
  - Due care, for example where the auditor considers only corroborative evidence compared to also considering the effects of conflicting evidence.

<sup>7</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

<sup>8</sup> ISA 200, paragraph 13(k)

- Training and education, skills and experience, which are necessary to cultivate an individual's ability to appropriately exercise professional skepticism.
20. While it is difficult for a single definition to fully capture the concept of professional skepticism, as noted above, the ISAs describe important elements that help in the understanding of what professional skepticism is intended to mean (see [February 2012 staff publication](#)).<sup>9</sup> Professional skepticism is also addressed in the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code)<sup>10</sup> and the International Accounting Education Standards Board (IAESB) standards.<sup>11</sup>
21. Although the ISAs explicitly recognize the fundamental importance of professional skepticism, audit oversight bodies and regulators have highlighted instances where they believe auditors have not clearly demonstrated appropriate professional skepticism in the planning and performance of their audit procedures. Some have also suggested that more robust documentation requirements, in particular related to the bases for the auditor's professional judgments and how appropriate professional skepticism has been applied, are needed in the ISAs.<sup>12</sup> The IAASB therefore believes that it is in the public interest to explore these matters further and challenge what more can be done to re-emphasize to both auditors and others the important role that professional skepticism plays in audits of financial statements.

#### *Establishment of a Joint Working Group*

22. The topic of professional skepticism is addressed in the standards that are issued by the IAASB, IESBA, and IAESB (collectively referred to as the standard-setting Boards or SSBs). A Joint Working Group comprising of representatives from each SSB has therefore been formed to explore on a broad level, what actions may be appropriate to respond to concerns that have been raised about the application of professional skepticism in audits. The objective of this Joint Working Group is to identify the conceptual issues related to professional skepticism across the ISAs, IESs and the IESBA Code, including where further alignment is warranted or where gaps may exist, and make observations or recommendations for further actions to be considered. It is envisaged that the discussions of the Joint Working Group, in conjunction with the interactions of Working Group members with their respective Boards, will enable the SSBs to consider what standard-setting activities may be appropriate and what other potential actions might be necessary to further enhance the application of professional skepticism by auditors.

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<sup>9</sup> ISA 200, paragraph 13(l)

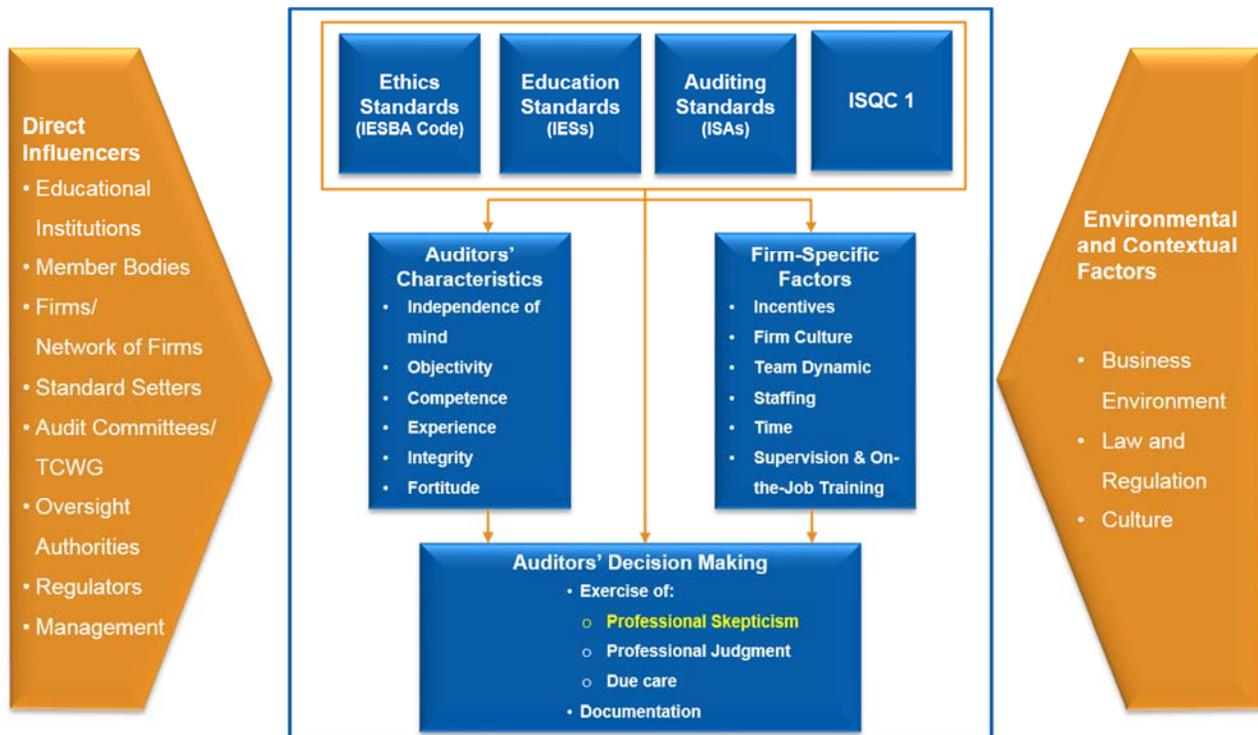
<sup>10</sup> The IESBA Code explicitly mentions the term professional skepticism in a number of places including in the definition of "independence" – both independence of mind, and independence in appearance. There is also a perceived connection between professional skepticism and the fundamental principle of objectivity and integrity, though there is not an explicit reference.

<sup>11</sup> International Education Standards (IES) 2, *Initial Professional Development-Technical Competence (Revised)*; IES 3, *Initial Professional Development-Professional Skills (Revised)*; IES 4, *Initial Professional Development-Professional Values, Ethics, and Attitudes (Revised)*; and IES 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)* provide guidance on the expected outcomes that assist professional accountants and engagement partners to demonstrate effective "professional skepticism" and "professional judgment." Both IES 8 and IES 4 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.

<sup>12</sup> It has also been suggested that consideration may be given to developing criteria that can be used to determine the quality, and effectiveness of professional skepticism that is applied by an auditor (e.g., a professional judgment framework) and that such criteria and framework should be established either at an international level or within the firm.

23. As part of its preliminary work, the Joint Working Group has developed a diagram (see paragraph 24) to illustrate some of its initial views about the potential interactions and contextual factors in relation to professional skepticism. This diagram focuses on those stakeholders with direct influence on the auditor’s application of professional skepticism.
24. The diagrams also illustrates that the suite of international standards (the ISAs, IESs and the IESBA Code) is collectively relevant to the exercise of professional skepticism in audits. Each set of standards addresses a specific area of focus. For example, the IESBA Code primarily deals with matters that are relevant to auditor’s characteristics (e.g., independence of mind and objectivity) and auditor’s decision-making (e.g. due care); the IESs focus on auditors’ characteristics (e.g., competence and experience) and ISQC 1 focuses on firm-specific factors, including leadership qualities (e.g., the “tone at the top”) within a firm; while the ISAs address matters that are relevant to the auditor’s decision-making (e.g., professional judgment and professional skepticism).

**Professional Skepticism: Interactions and Contextual Factors**



25. Preliminary discussions among members of the Joint Working Group indicate that standard-setting activities alone will not be sufficient to address issues relating to professional skepticism. Together with firms who are responsible for establishing a culture that fosters professional skepticism, others (including those charged with governance, regulators, audit oversight authorities, prudential supervisors and member bodies) are well- positioned to challenge and question the auditor’s exercise of professional skepticism in audits. Also, in light of the interactions contemplated in the AQ Framework (see AQ Framework at paragraph 9), the IAASB and IAASB Consultative Advisory Group believe that others also have an important role to play in enhancing auditor professional skepticism.
26. As a basis for developing its recommendations and observations, the Joint Working Group plans to start begin its exploration of the topic of professional skepticism by reviewing the extant suite of

international standards issued by each of the SSBs with a focus on understanding the following:

- What is meant by the term professional skepticism? Are the current description, the requirements and expectations clear to auditors and others? Are the linkages that exist between the term professional skepticism and other concepts such as professional judgement, due care, integrity, independence of mind, objectivity, and competence (see paragraph 17–18) sufficiently clear and well understood?
- What are the skills and competencies required for applying professional skepticism? What are the impediments affecting the consistent application of professional skepticism?
- How can it be determined that the exercise of professional skepticism has been appropriate given the circumstances?

27. The Joint Working Group plans to conduct outreach and seek input from respondents through the course of its work. Responses to this consultation on the topic of professional skepticism are expected to be useful in informing the Joint Working Group's work as it develops its observations and recommendations. Simultaneously, the IAASB welcomes the opportunity to obtain views from respondents about the changes that could be made to its standards to more directly encourage the application of professional skepticism, in the context of quality control and group audits.

28. For example, with respect to quality control, because professional skepticism within the engagement team is influenced both by the actions of the firm's leadership and the engagement partner, and by the culture and business environment of the firm, changes being considered in relation to ISA 220 and ISQC 1 may positively affect the application of professional skepticism in audits (see paragraphs 35–73). At the engagement level, ISA 220 requires the engagement partner to take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to members of the engagement team are intended to emphasize that quality is essential in performing audit engagements and promote the engagement team's ability to raise concerns without fear of reprisals and in issuing auditor's reports that are appropriate in the circumstances.

29. With respect to group audits various concerns have been raised relating to the judgments made by the group engagement partner and group engagement team in relation to various aspects of the group audit engagement. As revisions to the standards are contemplated, it will be important to consider what steps can be taken to better encourage appropriate exercise of professional skepticism with respect to these judgments (see paragraphs 63–73).

#### *Relevance to IAASB's Other Projects*

30. The topic of professional skepticism is relevant to all of the IAASB's individual projects, including those not covered by this consultation. For example, the IAASB has acknowledged that its work in relation to ISA 540 provides an opportunity to emphasize 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.

31. The Board's other planned projects (e.g., the project to address issues identified relating to ISA 315

(Revised)<sup>13</sup>), may also identify areas where further emphasis of professional skepticism may be useful.

### IAESB and IESBA Initiatives

32. The IAESB's recent consultation [recently approved, to be released by early December 2015] on its future strategy acknowledges the relevance of the topic of professional skepticism and poses a question to stakeholders about what actions may be specifically necessary by the IAESB to improve the professional competencies of auditors related to the exercise of professional skepticism.
33. The IESBA is actively contributing to the activities of the Joint Working Group with a view to determining whether there are areas within the IESBA Code where there would be benefit in elaborating on, emphasizing or clarifying ethical considerations relating to professional skepticism in ways that would support and complement the discussion of professional skepticism in the ISAs and the IESs. The IESBA will be kept apprised of the relevant issues by its representatives on the Joint Working Group as this initiative progresses.
34. Input from the IAESB's consultation, further understanding of relevant academic research, and feedback to this consultation will assist the Joint Working Group in developing its observations and recommendations to the SSBs, including the IAASB, about what is needed with respect to professional skepticism in the public interest.

## Strengthening the Standards Addressing Quality Control

### A NEW QUALITY MANAGEMENT APPROACH

35. An effective system of quality control supports consistent quality in all of the services a firm provides and is one of the essential components of how a firm manages itself. ISQC 1 provides the foundation for the approach to quality for firms of all sizes, and addresses requirements for a firm's system of quality control for audits and reviews of financial statements, and other assurance and related services engagements. ITC Paragraphs X-X
36. ISQC 1 requires a firm to develop policies and procedures that address key elements of a system of quality control. These elements include leadership responsibilities for quality within the firm, relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, human resources, engagement performance and monitoring. ISA 220<sup>14</sup> complements ISQC 1 by addressing quality at the individual audit engagement level.
37. As the environment in which firms operate evolves and the focus on quality intensifies, questions have arisen about whether ISQC 1 could be made more robust overall, as well as about specific matters that could be more explicitly or better addressed. The IAASB's ISA Implementation Monitoring project identified issues and concerns related to applying ISQC 1, and regulators and audit oversight bodies have identified this standard as requiring further consideration, in particular in relation to:

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<sup>13</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>14</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

- (a) More direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality, and the need for a strong “tone at the top” by firm leadership, including a focus on continually enhancing quality;
  - (b) Understanding causal factors of, and related remedial actions implemented to respond to, findings from both external and internal inspections;
  - (c) Monitoring the effectiveness of remedial actions and, where necessary, making adjustments to those actions when it becomes clear that they are not achieving the desired results;
  - (d) Establishing greater linkages between policies and procedures addressing human resource matters (e.g., recruitment, retention, training and remuneration) and accountability for quality.
38. The IAASB also acknowledges that ISQC 1 is perceived by some stakeholders as taking or appearing to require a “one size fits all” approach to quality control, i.e., with little regard or guidance to acknowledge how to deal with differences in the size and nature of the firm or the services the firm provides.

*Introduction to the Quality Management Approach*

39. The IAASB notes the competing challenges encountered with ISQC 1, including its application by firms of all sizes. In reflecting on the most appropriate way to revise ISQC 1 in response to the feedback received, the IAASB has considered and supports an approach that would involve a broader revision and restructure of ISQC 1 (i.e., as opposed to a targeted revision of its existing individual requirements and supporting application material.)
40. Such an approach would require firm leaders to take responsibility for a more proactive and innovative approach to managing quality and establishing the related supporting systems. Such an approach would involve identifying relevant risks to quality and designing appropriate policies and procedures to address those risks, and is referred to in this Overview as a “quality management approach” (or “QMA”). Firms have many different policies and procedures in place today to meet the objectives of ISQC 1, and which vary depending on the individual circumstances of the firm. A QMA would embed in ISQC 1, the importance of the interdependence of a firm’s policies and procedures that support consistent quality in all of the services a firm provides—a principle some firms may have already incorporated into their systems of quality control. In making broader revisions to ISQC1 to incorporate a QMA, the IAASB would concurrently address the specific issues and concerns with the current quality control requirements, potentially strengthening the requirements and enhancing the application guidance in the standard.
41. The IAASB also believes that such a redesign of its standards provides an opportunity to further demonstrate how ISQC 1 is scalable – in particular for SMPs who may not conduct audits of financial statements of listed entities (or audits at all). Specifically, the IAASB believes that requiring a QMA would support firms in designing and implementing effective quality management systems that:
- (a) Take account of the size and nature of the firm, the services the firm provides and the nature of the entities to whom those services are provided, and
  - (b) Are sufficiently flexible to take account of ongoing changes in the environment in which the firm operates, including changes in the legal and regulatory environment in the applicable jurisdiction(s) in which the firm operates.

Revising ISQC 1 in this manner may lead to changes to ISA 220. For example, there may be a need in ISA 220 to more explicitly address requirements for proactive management by the engagement partner of quality risks at the engagement level. Similarly, as revisions to ISA 600 are contemplated, consideration will be given to the implications for group audits of a QMA at the firm level. For example, the existence of a firm-level QMA may impact the engagement level considerations about acceptance and continuance of group audit engagements.

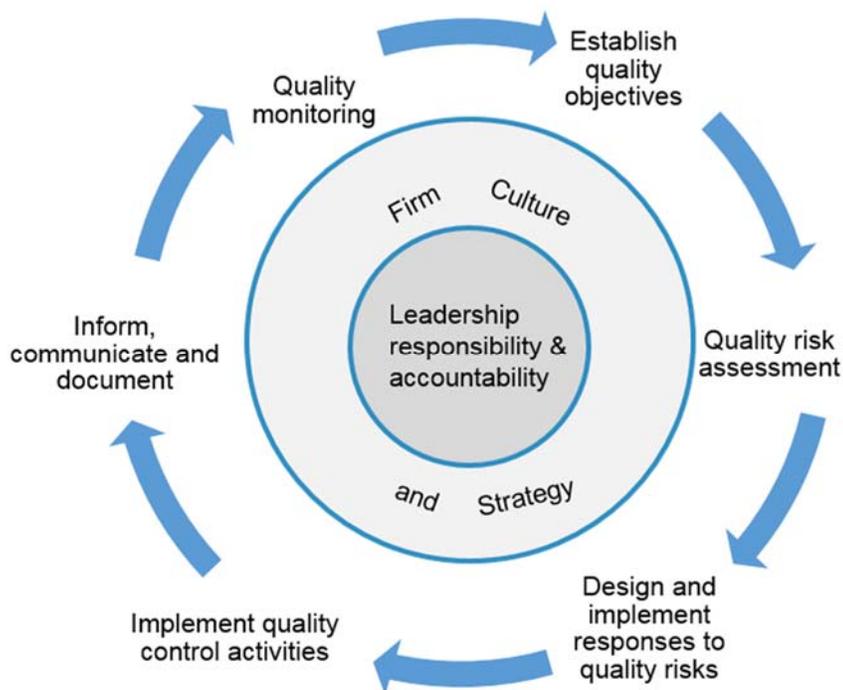
42. As described in the AQ Framework, a firm's culture has an important influence on the values, ethics and attitudes of partners and other members of the engagement team because the environment in which the engagement team works can materially affect the mindset of partners and staff, and consequently the way they discharge their responsibilities. The QMA would make it clear that firm leadership, as part of the firm's governance structure, is responsible for establishing the firm's overall culture and strategy, and thereby accountable overall for quality. A firm's culture will be an important factor in determining how its partners and staff are successful in serving the public interest as they perform audits.
43. A QMA may facilitate more effective integration of a firm's quality management system into other aspects of its management structures and business processes, thereby further enhancing a culture of focusing on quality throughout the firm, and accountability for quality by its leaders.

#### *Incorporating a QMA into ISQC 1*

44. Revising ISQC 1 to focus on a QMA may include using an approach that is similar to, or aligned with, principles in existing risk management and governance frameworks.<sup>15</sup> Key aspects of the IAASB's preliminary thinking about how ISQC 1 would incorporate a QMA include:
  - Incorporating the relevant activities in support of the continually evolving process of a QMA, the elements of which are set out in the diagram below.
  - Retaining the existing objectives and fundamental requirements in ISQC 1, although the way that the standard is structured would likely be revisited.

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<sup>15</sup> For example The Organization for Economic Co-operation and Development's (OECD) Principles of Corporate Governance; and The Enterprise Risk Management—Integrated Framework (2004) issued by the *Committee of Sponsoring Organizations* of the Treadway Commission (COSO ERM Framework). 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.



## Elements of the QMA

*Establish quality objectives*—build upon core principles of the firm’s strategy and culture. Direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality.

*Quality risk assessment*—identifying events and conditions that may have a significant effect on the firm’s ability to achieve the quality objectives.

*Design and implement responses to quality risks*—determining appropriate responses to address identified risks. The quality objectives serve as a framework for these decisions. For example, in an audit context, policies and procedures designed to respond to the identified risks would help with the delivery of a quality audit.

*Implement the quality control activities*—implementation of the quality control policies and procedures.

*Inform, communicate and document*—Identifying and capturing relevant risk information, and communication thereof, to relevant individuals to provide timely and relevant information to the firm’s leadership regarding the operation of the firm’s quality management system.

*Quality monitoring*—through both integrated and distinct monitoring activities. Continually improving the effectiveness of the quality management system, promoting the consideration by firm leadership of all feedback received on quality.

45. It has also been observed that corporate governance challenges that came into focus in the wake of the financial crisis caused many companies to revisit their business practices and relevant activities to respond to current and emerging corporate governance risks, including in priority areas such as remuneration, risk management, board practices and the exercise of shareholder rights. Revising ISQC 1 to incorporate the use of a QMA may provide the opportunity for the IAASB to provide

guidance as to how firms might, in appropriate circumstances, consider whether and how corporate governance principles<sup>16</sup> may be helpful or relevant in the context of identifying, assessing and responding to quality risks.

46. While stakeholders may have different views about the essential elements of a QMA and the relevant activities that have been described above, the IAASB believes that revising ISQC 1 to incorporate a QMA is responsive to stakeholders concerns, can be effectively implemented by firms of all sizes and, over time, will result in improved quality.

### **SPECIFIC ISSUES TO BE ADDRESSED AT THE FIRM AND ENGAGEMENT LEVEL IN REVISING THE QUALITY CONTROL STANDARDS**

47. The IAASB's deliberations to date have focused on 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.
48. In addition to considering redrafting ISQC 1 to incorporate the use of a QMA in addressing requirements for quality at the firm level, the IAASB believes that it is in the public interest that the respective roles and responsibilities of both firm leadership and the engagement partner are robust and clearly articulated within the IAASB's standards. It is also fundamental that the basis for any 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) is set forth clearly, particularly as the environment changes and challenges continue to emerge.

#### *Firm Level: Monitoring and Remediation*

ITC Paragraphs X-X

49. 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 as the basis for determining remediation activities and assessing their effectiveness. The IAASB is therefore considering enhancements to strengthen ISQC 1 by requiring policies and procedures to emphasize actions to be taken by a 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 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 as part of a Network of Firms*

50. 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 firms that operate as part of a network or alliance of firms may share common methodologies, and quality control and

ITC Paragraphs X-X

<sup>16</sup> For example, the OECD *Principles of Corporate Governance*

monitoring policies and procedures; however the extent to which they do, and the degrees of commonality, vary. Firms within a network or an alliance 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 firm's responsibilities under ISQC 1.

51. The IAASB's current standards do not establish any requirements at the network level nor do they address in any significant detail, a firm's ability to place reliance on network or alliance-level policies and procedures. It is therefore in the public interest that the IAASB consider the need for more clarity in the standards about what should be considered (and documented) by an individual firm as the basis for reliance on network or alliance-level policies and procedures (including for example, reliance on a common audit methodology or audit technology).
52. 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 that the nature and extent of common policies and procedures will vary. Additionally, structures may be highly influenced by applicable law or regulation in the various jurisdictions in which the network or alliances and individual firm(s) are established. As such, the IAASB believes it would be difficult to establish requirements for networks themselves.

#### *Firm Level: Transparency Reporting*

ITC Paragraphs X-X

53. There is an increasing trend of firms issuing publicly available 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 issuing such reports on a voluntary basis. However, current practices and the requirements for such reporting vary significantly between jurisdictions,<sup>17</sup> and may involve reporting on matters beyond the firm's system of quality control or other areas addressed by the IAASB's International Standards. Global organizations like the International Organization of Securities Commissions (IOSCO) are interested in the topic<sup>18</sup> and likely have the ability to influence a globally accepted form of, or requirements for, transparency reporting or common elements therein.
54. 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 and its effectiveness – could be feasible on a global basis, and if so, how that might be done.

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<sup>17</sup> Transparency reports are required in the European Union for 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 firm; (ii) a description of the network the firm belongs to (if applicable); (iii) governance structure of the firm; (iv) a description of the 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 firm has carried out statutory audits during the preceding financial year; (vii) a statement regarding the firm's independence practices; (viii) the continuing professional education policy of auditors within the firm; (ix) 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.

<sup>18</sup> In November 2015, IOSCO published a report on [Transparency of Firms that Audit Public Companies](#), which considers practices employed by audit firms and provides a Guide for transparency reporting.

*Engagement Level: Engagement Partner Roles and Responsibilities*

ITC Paragraphs X-X

55. 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 the engagement partner is allowed to rely on certain aspects of the firm's system of quality control, the importance of a proactive quality mindset by the engagement partner cannot be underestimated.
56. The IAASB believes that there are opportunities to strengthen the requirements in the ISAs in relation to the need for the engagement partner to demonstrate 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 address and are applied today to:
- Situations where other auditors are involved in an engagement that is not an audit of group financial statements (and to which ISA 600 does therefore not apply).<sup>19</sup> 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 should assess 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 how to address the potential implications for audit quality with respect to ADMs more broadly (including where they are part of a group audit). These considerations may for example, include how the firm's system of quality control should be applied and how work should be directed, performed, supervised and reviewed. ITC Paragraphs X-X
  - Situations where there are challenges for the engagement partner because of complex corporate structures, including complex multi-location (group) audits. How the role of the engagement partner is formally defined in the ISAs also raises questions in such circumstances. 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 as to the role of the engagement partner for particular circumstances that may arise in group audits due to complex corporate structures or structures not specifically addressed in ISA 600 today (such as for example, non-controlled components or an entity's use of shared service centers). These concerns also suggest a need to reflect on whether greater focus may be appropriate 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) the performance of appropriate reviews. ITC Paragraphs X-X
  - How the engagement partner becomes 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, ITC Paragraphs X-X

<sup>19</sup> 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.

such as fair value accounting estimates (including whether reliance on the work of the auditor's expert is appropriate in the circumstances).

57. Any changes to the ISAs also need to acknowledge that work of other auditors or auditor's experts may often be used as evidence to support the opinion on the financial statements. In exploring changes to the ISAs during the recently completed Auditor Reporting project, the IAASB initially questioned whether transparency could be improved by permitting or requiring disclosures in the auditor's report about the role of other auditors in the (group) audit. In finalizing the auditor reporting standards, and based on feedback from respondents to the consultation, the IAASB agreed to not pursue this. However, there continues to be feedback that providing users with information that enables them to evaluate the involvement and participation of other auditors may be helpful to providing increased transparency about the audit and how it was performed. The IAASB will therefore again explore whether greater transparency in the auditor's report about the involvement of others in the audit may be beneficial (i.e., making reference to the report of another auditor), including component auditors, other auditors and auditor's experts, including the nature and extent of such involvement.
58. In the context of its group audits project and in light of practical challenges that sometimes arise in some situations, the IAASB may also explore again the ability to use the report of another auditor as audit evidence, including when this might be appropriate, what requirements would be necessary for the group engagement team to address and possibly how and whether transparency may be provided in the auditor's report regarding this matter.

ITC Paragraphs X-X

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

ITC Paragraphs X-X

59. As a complement to the requirements set forth for engagement partners, firms are required to establish policies for audits of financial statements of listed entities to have an engagement quality control (EQC) review conducted by an EQC reviewer. Firms are also required to establish criteria to determine when other engagements should be subject to an EQC review. 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 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.
60. 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 timing and 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 establish criteria to have an EQC review should be potentially expanded beyond audits of listed entities.
61. The IAASB is also considering 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.

- Considering whether, and under what circumstances, communication between the EQC reviewer and the audit committee may be appropriate.
- Possibly providing transparency in the auditor's report that the engagement was subject to an EQC review, for example whether the audit of an entity other than a listed entity was subject to an EQC review.

62. 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.<sup>20</sup>

## **Strengthening the Standards Addressing Group Audits**

### **STRENGTHENING AND CLARIFYING HOW THE ISAs, INCLUDING ISA 220, APPLY IN A GROUP AUDIT**

63. Many audits today are audits of group financial statements (group audits), which generally involve participation of component auditors<sup>21</sup> who perform work on financial information related to components that comprise the group. Component auditors may be part of the same firm or same network or group of affiliated firms as the group engagement partner and group engagement team, or they may be from unrelated firms. Different types of component auditors give rise to different considerations for the group engagement team in terms of developing plans to be sufficiently involved in the work of component auditors.

64. Group audits may be particularly influenced by factors that add to the complexities and challenges of performing such audits. For example, 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.

65. As with any audit conducted in accordance with the ISAs, all relevant ISAs apply to group audits. ISA 600 deals with special considerations that apply to group audits, but specifically notes that the group engagement partner applies the requirements of ISA 220 regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial information of components.<sup>22</sup>

66. The IAASB understands that the interaction of the requirements, definitions, and guidance in ISA 600 is viewed by some stakeholders as limiting the flexibility of the standard, and that questions arise as to how to most effectively apply the standard in certain circumstances. For example, a group auditor faces practical challenges in some cases, such as when determining the nature, timing and extent of the required involvement in the work of component auditors, in addressing matters such as an entity's use of shared service centers or in establishing expectations in relation to consolidations performed at the regional or segment level. None of these matters are expressly addressed in ISA 600. In addition, significant issues and concerns relating to group audits have been highlighted by regulators and audit oversight bodies, including concerns about interpretations as to when ISA 600 does or does

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<sup>20</sup> In the US, the Public Company Accounting Oversight Board has a separate auditing standard for EQC review, Auditing Standard No. 7 (AS 7), *Engagement Quality Review*.

<sup>21</sup> A component auditor is an auditor who, at the request of the group engagement team, performs work on the financial information related to a component for the purpose of a group audit.

<sup>22</sup> ISA 600, paragraph 5

not apply, as well as insufficient assessments by group engagement teams of risks of material misstatement and responses thereto.

67. In addition to the risk of material misstatement of the group financial statements audit risk in a group audit also encompasses the possibility that a misstatement at the component level, or across components is not detected, which might result in the group financial statements being materially misstated. Issues may arise for a variety of reasons, including, for example, a component auditor failing to identify (or communicate to the group engagement team) a misstatement that could be material to the group either individually or when aggregated with other misstatements, or the group engagement team failing to evaluate the broader implications of a misstatement identified by a component at either the group level or for affected components.
68. It has been observed that scoping a group audit based on the identification of components (and identification of those that are significant) may not always result in an appropriate top-down approach to the assessment of the risks of material misstatement to the group financial statements and the planning and performance of appropriate responses to those risks. A further consequence of scoping based on the identification of components is that the work performed on the financial information may not always be appropriate or sufficient for the purposes of the group financial statements. For example, the requirement to perform an audit of financial information at significant components may not appropriately focus the work of a component auditor on those aspects that are likely to be most significant in relation to the group financial statements (i.e., when the risks of material misstatement related to the component's financial information are of varying levels of significance).
69. Given the importance of the identification and assessment of risks of material misstatement and the design of appropriate responses to achieving the outcome of a quality audit, the IAASB believes it is essential that the link in ISA 600 to the other ISAs that are most likely to always be relevant to the planning and performance of a group audit be sufficiently clear. In particular, the IAASB believes it is necessary to clarify, and potentially expand on, how the auditor is expected to apply the requirements in ISA 315 (Revised) and ISA 330<sup>23</sup> related to the identification and assessment of the risks of material misstatement and responding to those risks. For example, the IAASB could expand on how these ISAs are to be applied in relation to a group audit, by emphasizing the challenges in assessing and responding to risks of material misstatement at the group level, how to drive the assessment of these risks to the component level and the need for two-way communication with component auditors about these identified risks, responses and outcomes of the component auditor's work. The IAASB may also find it necessary to develop new guidance or requirements for auditors who serve as component auditors, which may be particularly useful to SMPs who may often function in this capacity.
70. In considering necessary changes to the ISAs, the IAASB needs to take into account that group structures are not consistent, and that entities that appear to have similar structures will typically have unique characteristics. Variations in competence and expertise of component auditors will also exist. As such, ISA 600 cannot be overly prescriptive in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors, nor can ISA 600 be expected to address all the different approaches that might be appropriate. It is important that the principles-based nature of the ISAs be preserved with a view to them continuing to be "fit for purpose" as structures continue to evolve. In this way, the ability of the auditor to manage and

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<sup>23</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

organize the audit engagement to respond to specific practical challenges related to the structure of the entity and related circumstances will be preserved. The IAASB believes that linking more clearly to important principles in other ISAs (e.g., relating to appropriate direction, supervision and review, and identifying and responding to identified risks of material misstatement) may better illustrate how ISA 600 would be expected to be applied or adapted in particular circumstances. In particular, the IAASB recognizes that a number of issues discussed in the context of its work on professional skepticism and quality control are likely relevant to the revision of ISA 600 – in particular, the group engagement partner’s responsibilities for the quality of the group audit.

71. The rest of this Overview sets out the issues that have been identified relating to group audits, and possible actions that the IAASB may consider.

### SPECIFIC ISSUES TO BE ADDRESSED IN REVISING ISA 600

72. In addition to considerations about the application of all relevant ISAs in an audit of group financial statements, there are other specific concerns that have been expressed in relation to ISA 600 that require further IAASB consideration. Situations where challenges or issues arise, and where the IAASB will consider what actions may be appropriate, include:

- Concerns about the robustness of the decision to accept or continue a group audit engagement, including demonstrating the engagement partner’s considerations when doing so, and considering the impact of mandatory auditor rotation in jurisdictions where component auditors are located. ITC Paragraphs X-X
- Where access by the group engagement team to the relevant financial information of components is restricted, and communication may be restricted. Specifically, concerns have been noted in practice about difficulties in obtaining access to either management or auditors at components that are non-controlled entities (e.g., when the entity accounts for particular investments using the equity method of accounting), although access issues are not limited to only these types of entities. ITC Paragraphs X-X
- Where entities are increasingly using shared service centers to perform financial reporting or accounting functions for some or all components within a group. When the use of centralized processing by the entity impacts the audit, the group engagement team may use other auditors to perform procedures at the shared service center, highlighting various questions about how to apply the ISAs. This issue also applies more broadly to other situations when shared service centers are involved and the audit is not a group audit. ITC Paragraphs X-X
- Where the engagement partner is not located where the majority of the audit work is performed (although, again, this is not solely an issue for group audit engagements). When the engagement partner is not physically located where the audit work is being performed, concerns have been raised about how the engagement partner demonstrates appropriate direction, supervision, performance and review of the work, the adequacy of the audit documentation, and whether and how the engagement partner has become satisfied that sufficient appropriate audit evidence has been obtained to enable the engagement partner to take responsibility for the auditor’s report in these circumstances. ITC Paragraphs X-X
- How the group engagement team demonstrates that it has been sufficiently involved in the group audit. For example, this could ITC Paragraphs X-X

include enhancements to the group engagement team's understanding about the component or the component auditors (e.g., about their competence or capabilities) sufficient to properly evaluate the nature and scope of their involvement to obtain sufficient appropriate evidence for purposes of the group audit.

- How appropriate and effective communication between the group engagement team and component auditors is taking place.
- How the concept of materiality is being applied at the component level.
- What an appropriate work effort of the component auditor is in the varying circumstances of group audits.

ITC Paragraphs X-X

ITC Paragraphs X-X

ITC Paragraphs X-X

73. The IAASB therefore intends to consider clarifying or strengthening the requirements in ISA 600 (and other ISAs as appropriate), as well as whether additional practical guidance (whether in the ISA or another Staff non-authoritative publication) would be effective in enhancing the quality of audits of group financial statements.

## **Questions for the Overview**

The following questions for respondents relate to the matters sent out in this Overview. They have been 'coded' as they relate to the different topics as explained below. These questions, as well as more detailed questions on the individual topics, can be found in the ITC (a listing of all questions relating to the consultation, coded in the same way, can be found in the Appendix to the ITC).

**(G = General question; PS = Professional Skepticism related question; QC = Quality Control related question; GA = Group Audit related question)**

G1. Paragraph 3 of the Overview describes what the IAASB believes are the most relevant public interest issues the Board should address in the context of its projects on quality control, group audits and professional skepticism. In the context of these three key projects:

- (a) Do you believe these public interest issues are relevant and meaningful to the Board's work on those topics? If not, why not?
- (b) Are there other public interest issues that would be relevant to those topics? If so, please describe them and how, in your view, they relate to the specific issues the IAASB plans to address in relation to the topics.

In your view, are there actions needed by parties other than the IAASB to address the public interest issues the IAASB believes are most relevant to enhancing audit quality in relation to these topics? If yes, what are they and which stakeholders have a role to play in this?

PS1. The IAASB is exploring what actions it could take to strengthen the application of professional skepticism in audits.

- (a) What are your views about how the concept of professional skepticism is described in the ISAs and addressed in the IESs and the IESBA Code (see paragraph 17 and footnote 11 above)?
  - (i) What are your views about the interactions and contextual factors depicted in the diagram at paragraph 24 above?
  - (ii) Are there other areas beyond those described in paragraph 26 that the Joint Working Group should explore?
  - (iii) What do you think should be done in the context of the IAASB's key projects (i.e., quality control and group audits) to further emphasize application of professional skepticism by auditors?
  - (iv) What are your views about how the IAASB as part of its other projects and activities (see paragraphs 30–31), could further challenge auditors to exercise professional skepticism in conducting audits?
- (b) In your view, what action(s) would be most meaningful for the IAASB to undertake in light of its mandate and why?
- (c) How may auditors better demonstrate the exercise of professional skepticism in the audit documentation?
- (d) What other actions may be necessary to strengthen the application of professional skepticism and who, in your view, is best placed to carry out these actions (e.g., other standard setters, firms and member bodies, etc.)?

QC1. The IAASB is strongly considering a broader revision of ISQC 1 that would embed an approach to quality control that would require firm leaders taking responsibility for managing quality in a more proactive and innovative way(see paragraphs 35–46).

- (a) Do you believe that the use of a QMA would assist in improving audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate such an approach?
- (b) If you support the use of a QMA by firms, are there other elements that you think should be explicitly included in such an approach in light of its objective (as outlined in paragraph 44)?
- (c) In your view, how might this change to ISQC 1 impact other ISAs, including ISA 220?

QC2. Specific issues have been noted in relation to quality control that suggest improvements to ISQC 1 and ISA 220 are necessary. In addition to considering restructuring ISQC 1 to reflect a QMA, the IAASB is also exploring how those standards may need to be revised to respond to those issues (see paragraphs 47–62).

- (a) Do you believe the actions the IAASB is exploring would be meaningful and would improve audit quality at the firm and engagement level? If not, why not?
- (b) Are there other actions that you think would be necessary in the public interest for the IAASB to take to address the issues highlighted? Are there other issues of which you are aware? If so, please describe such actions and your supporting rationale as to why they require priority attention.

GA1. Specific issues have been noted in relation to group audits that suggest improvements to the ISAs are necessary. The IAASB is exploring how ISA 600 (and potentially other standards) may need to be revised to respond to those issues.

- (a) Do you believe that more specific emphasis on the application of all relevant ISAs in an audit of group financial statements in ISA 600 is appropriate and that it will help achieve the flexibility that is needed to allow for its application in a broader way, and to a wide range of circumstances (see paragraphs 63–71)? If not, please explain why and provide any additional actions you believe the IAASB could undertake to address issues set out in this consultation.
- (b) Do you believe the actions the IAASB is exploring in relation to the issues raised regarding ISA 600 would be meaningful and would improve the quality of group audits? If not, why not?
- (c) Are there other actions that you think would be necessary in the public interest for the IAASB to take to address the issues highlighted or other issues of which you are aware (see paragraphs 72–73)? If so, please describe such actions and your supporting rationale as to why they require priority attention.

G2. Enhancing audit quality will continue to be a theme as the IAASB develops its *Work Plan for 2017 – 2018*. To assist the IAASB in this regard, are there other actions not specific to the topics of quality control, group audits or professional skepticism that you believe need to be undertaken by the IAASB to address the threats to audit quality more broadly? If yes, what are they and how should they be prioritized?