

## **Audit Quality**

### **Background**

1. The International Auditing and Assurance Standards Board (IAASB) is currently finalizing its project on audit quality, the objective of which is to establish in the public interest an international framework that describes audit quality holistically. Given the linkage between compliance with ethics standards and audit quality, the IESBA had accepted an invitation from the IAASB for an IESBA member to participate in the project Task Force, and assigned Don Thomson to serve as IESBA liaison in this regard.
2. At its October 2011 meeting, the IESBA was briefed on the progress of the project and provided feedback on a draft of the proposed framework for the Task Force's consideration. In September 2012, a near-final version of the consultation draft of the proposed framework was circulated to the IESBA for review on a fatal-flaw basis, and some IESBA comments, which were not significant, were fed back to the Task Force.
3. In January 2013, the IAASB published its consultation paper, *A Framework for Audit Quality* (Framework).<sup>1</sup> The proposed Framework is intended to, amongst other things, assist international standard setting. As explained in the foreword to the consultation paper, the proposed Framework describes the input and output factors that contribute to audit quality at the engagement, audit firm and national levels for financial statement audits. Ethics and auditor independence are addressed, with specific mention of the IESBA *Code of Ethics for Professional Accountants* and its fundamental principles. The Framework also demonstrates the appropriate interactions among stakeholders and the importance of various contextual factors.
4. The IAASB has received 76 responses. These responses have been considered by the Task Force, and an updated draft Framework will be discussed at the September 16-20, 2013 IAASB meeting.<sup>2</sup> This updated draft does not significantly change the coverage of ethics and auditor independence in the September 2012 version that was circulated to the IESBA for fatal flaw review and on which IESBA members did not express any significant concerns. IESBA members, however, are invited to contact Don Thomson if they have any questions or comments concerning this updated draft.

### **Open Discussion**

5. In its consultation paper, the IAASB had identified 10 areas where it thought that further consideration may benefit audit quality on a global basis. The Appendix to this paper describes those areas particularly relevant to the IESBA, with details of input provided by respondents.
6. The IAASB Task Force has identified a number of matters in areas relevant to the IESBA for possible further consideration by the IESBA.
7. The IESBA is asked to consider these matters as it develops its future strategy and work plan.

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<sup>1</sup> See <http://www.ifac.org/publications-resources/framework-audit-quality>

<sup>2</sup> The updated draft of the Framework to be discussed at the September 2013 IAASB meeting can be accessed at: [http://www.ifac.org/sites/default/files/meetings/files/20130916-IAASB-Agenda\\_Item\\_3B-AQ-CLEAN\\_Updated\\_Framework-final.pdf](http://www.ifac.org/sites/default/files/meetings/files/20130916-IAASB-Agenda_Item_3B-AQ-CLEAN_Updated_Framework-final.pdf).

**Matters for Consideration**

1. Is there a need for additional guidance to expand upon some of the fundamental principles in the Code as they apply to auditors – especially Professional Competence and Due Care (s 130) and Professional Behavior (s 150)?
2. Is there a need to establish a closer link between the fundamental principle of Professional Competence and the standards of the International Accounting Education Standards Board (IAESB) addressing competence?
3. The audit engagement team needs to be committed to performing the audit in the interests of stakeholders and the wider public interest. Is there more that can be done to emphasize this in the Code? (See references to acting in the public interest in paragraphs 100.1 and .6 of the Code.)
4. Is there more that can be done to encourage auditors to share information about the audit with users, perhaps at the AGM? (See Confidentiality s 140.)
5. Is there more to be done to improve information sharing between firms when one firm decides to resign from, or is not reappointed to, an audit engagement? (See Confidentiality s 140 and Professional Appointment s 210 – particularly paragraph 210.13.)
6. Is there more to be done to encourage improved information sharing with regulators? (See Confidentiality s 140 – particularly paragraph 140.7.)
7. If guidance on audit firm governance were to be developed and promulgated, which standard-setting board would lead that effort?
8. The International Organization of Securities Commissions (IOSCO) has suggested that the IAASB develop a process for “analyzing root causes of audit failures.” If this were to be undertaken, are there ethics issues to consider?

## Appendix

Note: The following information has been extracted from Agenda Item 3-E of the September 2013 IAASB Meeting.<sup>3</sup>

**Area to Explore 2 – Establishing a common understanding of capabilities and how they are demonstrated and assessed, as they relate to audit quality for use by audit firms when recruiting, evaluating, promoting, and remunerating partners and staff.**

“Audit firms often use competency frameworks to assist with evaluating the performance of partners and staff. However, the extent to which the competences used directly address audit quality, and the manner in which this is done, vary. There may be benefit in standardizing elements of audit firm competency frameworks, perhaps using the competences that have been developed by the IAESB (see also paragraph 98 [of the IAASB consultation paper]).

“Further specification of the necessary competences will also give audit firms the opportunity to consider whether their current approach to staff recruitment and training is providing the appropriate resources for the performance of quality audits.”

### SUMMARY OF COMMENTS RECEIVED

- (a) *Level of support.* In addition to the fifteen respondents<sup>4</sup> who supported additional work on all Areas to Explore a further eleven respondents either supported<sup>5</sup> or strongly supported<sup>6</sup> additional work in this Area. Six respondents considered this an area of low priority.<sup>7</sup>
- (b) *Opportunities identified.* Opportunities that were identified included:
  - (i) Guidance in this area would help provide the bridge between theoretical thinking on audit quality and an individual auditor’s daily work; and
  - (ii) Work in this area would give an opportunity to consider new competencies such as communication and other interpersonal skills.

<sup>3</sup> [http://www.ifac.org/sites/default/files/meetings/files/20130916-IAASB-Agenda\\_Item\\_3E-AQ-Areas\\_to\\_Explore-final.pdf](http://www.ifac.org/sites/default/files/meetings/files/20130916-IAASB-Agenda_Item_3E-AQ-Areas_to_Explore-final.pdf)

<sup>4</sup> Supported additional work on all areas to explore – American Accounting Association, American Institute of Certified Public Accountants, BDO International Limited, Chartered Accountants Ireland, European Federation of Accountants and Auditors for SMEs, Federation of European Accountants (FEE), Financial Reporting Council (UK), Institut der Wirtschaftsprüfer (Germany), the Institute of Certified Public Accountants Ireland, Institute of Chartered Accountants of Australia, The Korean Institute of Certified Public Accountants, Malaysian Institute of Accountants, National Audit Office (Sweden), Pitcher Partners (Australia), Zambia Institute of Chartered Accountants

<sup>5</sup> Supported additional work on IAASB Area to Explore 2 – Canadian Auditing and Assurance Standards Board, Institute of Certified Public Accountants of Singapore, Nederlandse Beroepsorganisatie van Accountants

<sup>6</sup> Strongly supported additional work on IAASB Area to Explore 2 – Association of Chartered Certified Accountants, Baker Tilly (UK), Canadian Public Accountability Board, Hermes Equity Ownership Services Limited (UK), Institute of Chartered Accountants of England and Wales, Institute of Chartered Accountants of Scotland, International Corporate Governance Network (UK), Wales Audit Office

<sup>7</sup> Considered IAASB Area to Explore 2 a low priority – Australasian Council of Auditors-General, Cayman Islands Auditors Oversight Authority, New Zealand Auditing and Assurance Standards Board, Sizwe Ntsaluba Gobodo (SA), The South African Institute of Chartered Accountants

- (c) *Risks identified.* Risks that were identified included:
- (i) Many groups may need to be involved including standard setters, education providers, regulators, and professional bodies;
  - (ii) Different types and size of audits require different competencies; and
  - (iii) Cultural differences, firm structures, and outsourcing may mean that it is impractical to achieve a global position.
- (d) *Other comments*
- (i) IAESB and IESBA set out minimum requirements; firms need a level of autonomy in relation to recruiting, evaluating and remunerating staff.
  - (ii) Competencies of engagement partners are already covered by IES 8 – any new work, for example, establishing competencies for other team members, needs to be coordinated with IAESB.
  - (iii) The UK FRC and ICAS are undertaking research into the competencies needed by auditors.
  - (iv) There may be value in extending this Area to look at firms' business models and the composition of audit teams.
  - (v) This Area could usefully be informed by research into whether the necessary attributes are inherent or learned and, if learned, what types of educational programs are the most effective in teaching them.

**Area to Explore 3 – Improving information sharing between audit firms when one firm decides to resign from, or is not reappointed to, an audit engagement.**

“There can be many reasons why an audit firm may cease to act as an entity’s auditor. Reasons include, among others, concern about the entity’s business practices, accounting policies and the integrity of management or those charged with governance. Knowledge of such reasons could influence another audit firm from accepting the engagement or, if it is accepted, significantly impact the audit approach.”

“Ethics standards normally require an incoming auditor to determine whether there are reasons for not accepting an audit engagement; however an outgoing auditor may believe that the duty of client confidentiality may prevent the communication of relevant information. In some countries there are specific laws or regulations that impact information sharing and the extent to which shareholders are made aware of relevant circumstances. Consideration could usefully be given to how information sharing can be improved and thereby reduce the risk of high-risk audits being undertaken by audit firms without the necessary background information and possibly without the requisite skills and experience.”

SUMMARY OF COMMENTS RECEIVED

- (a) *Level of support.* In addition to the fifteen respondents who supported additional work on all Areas to Explore a further eleven respondents either supported<sup>8</sup> or strongly supported<sup>9</sup> additional work in this Area. Only one respondent considered this was an area of low priority<sup>10</sup>.

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<sup>8</sup> Supported additional work on IAASB Area to Explore 3 – Australasian Council of Auditors-General, Baker Tilly (UK), Certified General Accountants Association (Canada), Nederlandse Beroepsorganisatie van Accountants, New Zealand Auditing and Assurance Standards Board, Sizwe Ntsaluba Gobodo (SA)

- (b) *Opportunities identified.* Opportunities that were identified included:
- (i) Practice varies internationally;
  - (ii) Work in this Area would encourage countries to introduce national law or regulation that provides for the necessary information flow; and
  - (iii) Work in this Area would reduce the risk associated with a change in auditor.
- (c) *Risks identified.* Risks that were identified included:
- (i) The scope for information sharing may be limited to the extent allowed by national law and regulations;
  - (ii) Sharing too much information could defeat the purpose of changing auditors if the incoming auditor's knowledge is framed in the views of the predecessor auditor; and
  - (iii) Client confidentiality and competition between audit firms are possible impediments.
- (d) *Other comments*
- (i) Some countries have supplemented the *IESBA Code* (which adopts a threats and safeguards approach) with specific required procedures. Information flows are also addressed by legislation in EU.
  - (ii) The scope for harmonization will be influenced by the ethical arrangements in each jurisdiction. There would be value in IAASB and IESBA working together on this topic.
  - (iii) This is more of a process issue than one that needs to be prioritized for audit quality.
  - (iv) This is not often an issue for public sector auditors.
  - (v) Information sharing should be limited to that needed to enable the incoming auditor to form a basis for reliance on opening balances.
  - (vi) Any additional guidance should address the risks arising from sharing information.

**Area to Explore 8 – Achieving improved two-way communication between auditors and financial and prudential regulators, particularly in the financial services sector.**

“While it is recognized that the timely sharing of appropriate information between regulators and auditors can both enhance the regulatory process and contribute to audit quality, such information sharing is sometimes inhibited by timing and confidentiality issues. To improve information sharing clear criteria for what is to be communicated and the process for such communications need to be established either in law or by means of formal agreements or protocols.”

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<sup>9</sup> Strongly supported additional work on IAASB Area to Explore 3 – Federation of Accounting Professions (Thailand), FAR (Institute for the Accountancy Profession in Sweden), Institute of Certified Public Accountants of Singapore, Internal Audit Department of Pension Administrators (MN Services and PGGM – Netherlands), International Corporate Governance Network (UK)

<sup>10</sup> Considered IAASB Area to Explore 3 a low priority – The South African Institute of Chartered Accountants

SUMMARY OF COMMENTS RECEIVED

- (a) *Level of support.* In addition to the fifteen respondents who supported additional work on all Areas to Explore a further eighteen respondents either supported<sup>11</sup> or strongly supported<sup>12</sup> additional work in this area. Two respondents considered this was an area of low priority.<sup>13</sup>
- (b) *Opportunities identified.* Opportunities that were identified included:
  - (i) Improved communication would assist auditors understand key risks and areas to cover and enhance auditors' understanding of the regulators' requirements; and
  - (ii) It will also assist regulators understand the audit process and its outcomes.
- (c) *Risks identified.* Risks that were identified included:
  - (i) The scope for harmonization may be limited as information sharing is facilitated and enforced by national legislation.
- (d) *Other comments*
  - (i) There would be benefit in expanding the definition of regulators beyond the financial services sector.
  - (ii) Satisfactory arrangements are already in place in some countries.

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<sup>11</sup> Supported additional work on IAASB Area to Explore 8 – Australian Auditing and Assurance Standards Board, Canadian Auditing and Assurance Standards Board, Certified General Accountants Association (Canada), Federación Argentina de Consejos Profesionales de Ciencias Económicas (Argentine Federation of Professionals Councils of Economic Sciences), Independent Regulatory Board for Auditors (South Africa), Institute of Chartered Accountants of England and Wales, Institute of Chartered Accountants of Scotland, Internal Audit Department of Pension Administrators (MN Services and PGM – Netherlands), Nederlandse Beroepsorganisatie van Accountants, New Zealand Auditing and Assurance Standards Board, Sizwe Ntsaluba Gobodo (SA), The South African Institute of Chartered Accountants

<sup>12</sup> Strongly supported additional work on IAASB Area to Explore 8 – Baker Tilly (UK), Compagnie Nationale des Commissaires aux Comptes (France), FAR (Institute for the Accountancy Profession in Sweden), Hong Kong Institute of Certified Public Accountants, KPMG IFRG Limited (network), PricewaterhouseCoopers International Limited

<sup>13</sup> Considered IAASB Area to Explore 8 a low priority – Australasian Council of Auditors-General, Institute of Certified Public Accountants of Singapore