May 13, 2016

International Auditing and Assurance Standards Board
C/o International Federation of Accountants
529 Fifth Avenue
New York, New York 10017
United States of America

Re: Comments to the IAASB’s Overview and Invitation to Comment: Enhancing Audit Quality in the Public Interest

Dear Ladies and Gentlemen:

The International Bar Association would like to take this opportunity to comment on the Overview and Invitation to Comment: Enhancing Audit Quality in the Public Interest published by the International Auditing and Assurance Standards Board (the “IAASB”) in December 2015.

The International Bar Association (IBA), the global voice of the legal profession, includes over 45,000 of the world’s top lawyers and 197 Bar Associations and Law Societies worldwide.

We are submitting our comments through the Capital Markets Forum, which has over 460 members from around the world. The Capital Markets Forum is a private sector initiative set up to monitor and assist in the orderly development of capital markets, while recognizing the importance of the legal role in providing a framework in which market forces can work most efficiently, and in setting the parameters of fair behavior. The Capital Markets Forum formed a working group to respond to this consultation, and those working group members are named at the end of this document.

The comments made in this letter are the personal opinions of the working group members and should not be taken as representing the views of their
firms, employers or any other person or body of persons apart from the IBA Capital Markets Forum, of which they are members.

We would like to express our support for the IAASB’s continued efforts to improve audit quality, of which the Overview and the Invitation to Comment form a part. Audits of financial statements play a crucial role in the orderly functioning of the capital markets worldwide, providing investors with much-needed confidence in the quality and integrity of the financial statements of issuers with listed or publicly traded securities. Audited financial statements constitute, or form the basis of, many of the most important disclosures that the issuers of securities make, and upon which markets accounting for billions of dollars in daily trading activity rely. Accordingly, measures to improve the audit function and investors’ confidence in audit quality are of utmost interest, not merely to investors but also to those concerned with the proper functioning of capital markets generally.

With that background in mind, the focus of our comments is on those parts of the Overview and Invitation and Comment that relate to transparency. Regardless of which measures to improve audit quality that the IAASB pursues, they will fail to achieve their full promise if they are not adequately communicated to market participants. For public confidence in audit quality to be improved, not only must relevant and effective measures be adopted and implemented, but the fact and means of their implementation must be made known to the investing public.

This is particularly the case as markets become more complex. New industries, new geographies, new companies, and new types of securities all increase the diversity of investments available for offer to, and trading by, the wider public. While this diversity offers investors many advantages in terms of risk allocation, it also renders their decision-making processes more complex, as vastly greater amounts of information must be analyzed before well-informed investment decisions can be made. This additional complexity heightens the need for accuracy and integrity of the information used to make investment decisions, particularly critical disclosures -- audited financial statements foremost among them -- that make up the central focus of any well-informed investment decision. The IAASB’s efforts to improve the quality of audits of financial statements, particularly those of entities with publicly traded securities, are therefore of critical importance to achieving the benefits that broad and deep capital markets can provide.

Because measures to secure acceptable levels of audit quality are of significant interest to the investing public, we believe that the IAASB’s efforts in this area should specifically consider and address how factors relevant to audit quality are made known to market participants. We note that many jurisdictions provide for audit firms to make public so-called “transparency reports” that address various aspects of the firms’ operations. Some firms issue such transparency reports even where not required by law or regulation to do so. To the extent that these transparency reports address matters relevant to audit quality — such as quality control systems generally or the audit firm’s procedures requiring quality reviews by personnel outside the audit engagement.
team — such reports can make an important contribution to investor confidence in audit quality. We therefore encourage the IAASB to take note of the spread and development of transparency reports by audit firms, and would be supportive of efforts by the IAASB to provide guidance to audit firms producing such reports, whether pursuant to applicable law or regulation or otherwise.

We note, however, that the scope of any particular audit firm’s transparency report is limited to the issuing audit firm itself, and is focused on that audit firm’s audits generally rather than on the audit of any specific issuer’s financial statements in particular. To that extent, the ability of transparency reports to foster market confidence in audit quality can operate only at an aggregate level.

To improve confidence in audit quality as relates to the financial statements of a particular issuer, however, measures other than transparency reports must be used. We note in this regard that IAASB’s new ISA 701 Communicating Key Audit Matters in the Independent Auditor’s Report is scheduled to go into effect in the near future. ISA 701 requires auditors to communicate “key audit matters” — those that in the auditor’s judgment are of most significance in the audit of the current period’s financial statements — in the auditor’s report for audits of financial statements for listed entities. We believe that the communication of key audit matters within the audit report pursuant to ISA 701 provides a potentially useful avenue by which auditors can also provide information about matters relevant to the quality of the specific audit. As such, the use of ISA 701 communications of key audit matters could, with limited modification, form an important supplement to transparency reporting in fostering investor confidence in audit quality. Such reporting under ISA 701 would complement, at the engagement level, the more aggregated information that transparency reports provide at the level of the audit firm.

Through a limited modification to the definition of “key audit matters” within ISA 701, the IAASB could expand the scope of matters to be communicated with the audit committee and then to the investing public via the audit opinion. The discussion in the audit opinion could thus include a discussion of matters that, in the auditor’s professional judgment, bear on audit quality. Such factors could include, for example, a discussion of whether the audit engagement was subject to engagement quality review by the audit firm and what procedures such review involved, or a discussion of how the auditor took into account past inspections findings by audit regulators to improve the audit. Other possibilities for discussion could include summaries of significant audit-related discussions with management or those charged with governance (especially the audit committee). We therefore encourage the IAASB to consider the scope of possibilities offered by potential revisions to ISA 701 to improve engagement-level transparency as it relates to audit quality specifically.
We would also like to take this opportunity to comment briefly on a separate question raised in the Overview and Invitation to Comment with respect to group audits, namely the subject of materiality. We are supportive of the IAASB’s efforts to clarify the respective roles and responsibilities of group auditors and component auditors, particularly in the context of group audits involving numerous diverse and widely spread components. When considering future measures in this area, however, the IAASB should, in our view, keep firmly in mind the prospect that group audit clients may well suffer material liability, exposures or events within components that are themselves immaterial. To take a simple example, an environmental catastrophe suffered at a property owned by an immaterial subsidiary could, depending on the facts and circumstances, potentially be material a group level. We urge the IAASB to be mindful of this possibility when setting standards governing the relationship between materiality at group and component levels. Any resulting standards should be drafted so as to minimize the risk that potentially material events, wherever they occur within a group structure, might not be given due attention in the course of an audit.

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We thank you for the opportunity to comment on the Overview and Invitation to Comment and look forward to further dialogue on these issues.

Sincerely yours,

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Amsterdam

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IBA's representative to the Consultative Advisory Group of the IAASB

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