

International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY
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01 July 2019

Dear Sirs

Exposure Draft February 2019: Proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

PKF South Africa Inc (“PKFSA”), administers the PKF network of legally independent member firms in South Africa. PKF in South Africa practise as separate entities in Eastern Cape, Free State, Gauteng, KwaZulu-Natal and Western Cape. PKFSA is a member firm of PKF International Limited, which is a member of the Forum of Firms and is dedicated to consistent and high-quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKFSA, but not necessarily the views of any specific member firm or individual.

We welcome the opportunity to comment on the International Auditing and Assurance Standards Board's (IAASB's) Exposure Draft on the Proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements.

We are supportive of the IAASB's efforts to drive improvements in quality at both a firm level and at the engagement level through its development of ED-ISQM 1 and the related exposure drafts ISQM 2 and ISA 220. We believe that this suite of proposed quality standards will ultimately help to address the objectives that the IAASB set for this project.

We believe that there is still an opportunity to make further enhancements to ED-ISQM 1, particularly in the following aspects:

Scalability – The requirements in ED-ISQM 1 for a firm to consider its own specific circumstances when assessing the risks to its quality objectives will enhance firms' systems such that the system of quality management is customised to its unique circumstances, avoiding a “one size fits all” approach. This is a welcome (intended) benefit of ED-ISQM 1 compared to ISQC 1. However, the inherent tension between scalability through a new risk-based approach and the IAASB's conclusion to retain the requirements from extant ISQC 1 as either required quality objectives or responses, negatively impacts scalability. There are various parts of ED-ISQM 1 which could still be made more scalable than currently proposed.

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Given the wide range of size and circumstance of all the types of firm to which the proposed standard would apply, it is critical that it is written with scalability being a key objective. Our responses to the request for comments include several examples of where we believe further scalability could be introduced into ED-ISQM 1. For each of these we encourage the IAASB to consider them as part of its efforts to optimise the scalability of the standard in its final version.

Clarity – We believe that ED-ISQM 1 is a well-structured standard and that it has generally been written with both clarity, and practicality of application, in mind. Nonetheless, in our responses we have highlighted certain sections of ED-ISQM 1 which we believe should be revised in order to further enhance the clarity of wording and reduce the risk of different interpretations. The broad range of stakeholders in the proposed standard (including national regulators, public oversight bodies, local standard setting bodies, members of the public and of the investment community, as well as the firms to which the standard's requirements will be applicable) will collectively increase the risks of inconsistent application and diverging interpretation of the requirements. We encourage the IAASB to address the areas of ambiguity that we have identified and, for each of these areas, to consider how to improve the clarity of the language used.

Risk Assessment Process – we agree with the overall approach that ED-ISQM 1 takes on the risk assessment process, which places it as a critical and foundational part of a firm's system of quality management. In our comments, we have highlighted some specific concerns around the risk of different interpretations on the requirements and guidance on risk assessment. We believe it is critical that the standard is abundantly clear and unambiguous on its requirements in this area, since the risk assessment process will form the basis for the design of the responses that a firm establishes in order to meet the objectives of its system of quality management. In a worst-case scenario, should a regulator or other oversight body take a differing view to a firm on how it should perform its risk assessment, this could render the firm's whole system of quality control non-compliant with the proposed standard. In order to reduce this risk, we encourage the IAASB to consider those aspects of the requirements and accompanying guidance on risk assessment in ED-ISQM 1 which are unclear or ambiguous and that it takes the opportunity to ensure that the wording is clarified in the final version of the standard.

Harmonisation with other jurisdictions – we encourage the IAASB to maintain communications on harmonisation of global standards on quality management with those countries and jurisdictions in which the ED-ISQM 1 would not, or may not, be directly applicable, for example the USA. Additionally, we encourage the IAASB to provide related guidance material for use by global networks and by ISQM 1 compliant firms which may intend to use a non-ISQM 1 firm as a component auditor in a group audit engagement. Such guidance should be aimed at helping networks and firms to better understand both the risks to their own compliance with ISQM 1 which arise from interactions with non-ISQM 1 firms, as well as how to design and implement acceptable responses in mitigation to these risks. Our responses to the questions raised in the request for comments are contained in [Appendix 1](#) of this submission.

If you would like to discuss any of our comments, do not hesitate to contact me.

Yours sincerely



Theo Vermaak

Chairman
PKF South Africa Inc.

Appendix 1

Request for comments

Overall Questions

Question 1

Does ED-ISQM 1 substantively enhance firms' management of engagement quality, and at the same time improve the scalability of the standard? In particular:

- (a) Do you support the new quality management approach? If not, what specific attributes of this approach do you not support and why?*
- (b) In your view, will the proposals generate benefits for engagement quality as intended, including supporting the appropriate exercise of professional skepticism at the engagement level? If not, what further actions should the IAASB take to improve the standard?*
- (c) Are the requirements and application material of proposed ED-ISQM 1 scalable such that they can be applied by firms of varying size, complexity and circumstances? If not, what further actions should the IAASB take to improve the scalability of the standard?*

Response

The proposed requirements in ED-ISQM 1, in general, will enhance firms' management of engagement quality.

- a. In general, we support the new quality management approach.
- b. The proposals are likely to generate benefits for engagement quality. They will also support the appropriate exercise of professional skepticism at the engagement level.
- c. The requirements and application material do provide a degree of scalability to firms of varying size, complexity and circumstances. We already commented in our covering letter on the inherent tension between retaining the requirements of extant ISQC 1 and the objective of introducing scalability. The precise degree to which ED-ISQM 1 can be scaled will require the exercise of professional judgement and is an aspect of the standard which may be open to different interpretations. We have a concern that firms and regulators may apply differing interpretations on the extent to which ED-ISQM 1 can be scaled.

In addition, the proposed requirements, in combination, will require that a firm allocates a significant incremental amount of time and resource to design, implement and operate its new quality management system, compared with the effort required to comply with extant ISQC 1. Regarding its public communications around ED-ISQM 1, we recommend the IAASB communicates clearly to manage firms' expectations on the extent of the incremental effort that will necessarily be incurred in complying with the standard's requirements. Such communications should be sufficiently clear to reduce the risk that firms misinterpret the scalability benefits of ED-ISQM 1, to infer that the new standard will take less effort to comply with than extant ISQC 1.

Outside of the main body of ED-ISQM 1, the IAASB has issued supplementary materials covering scalability of the standard by SMPs which, for example, includes relevant guidance that certain responses to quality risks may not necessarily need to be subject to

documentation as a written policy or procedure by an SMP. We recommend that all such guidance on scalability be considered for inclusion within the main body of the standard, as opposed to being confined to webinars and other supplementary materials. This would provide a more robust and authoritative basis for the scaling of the requirements of ED-ISMQ 1 and, in particular, would support SMPs in designing a system of quality management that is appropriately tailored to their circumstances.

The IAASB has also published the document “DRAFT EXAMPLES: HOW THE NATURE AND CIRCUMSTANCES OF THE FIRM AND THE ENGAGEMENTS IT PERFORMS AFFECT THE IMPLEMENTATION OF PROPOSED ISQM 1”. While it is helpful, the range of circumstances covered by the examples is very narrow, without covering several common circumstances of many firms and networks. In addition, the scalability examples used in the materials are not particularly onerous (e.g. not obtaining annual independence declarations is not a significant “concession”). Therefore, we recommend that a wider range of additional examples should be included within this document.

Question 2

Are there any aspects of the standard that may create challenges for implementation? If so, are there particular enhancements to the standard or support materials that would assist in addressing these challenges?

Response

We have commented elsewhere within this submission on those aspects of ED-ISQM 1 that may create challenges for implementation.

Question 3

Is the application material in ED-ISQM 1 helpful in supporting a consistent understanding of the requirements? Are there areas where additional examples or explanations would be helpful or where the application material could be reduced?

Response

The application material is generally helpful in supporting a consistent understanding of the requirements. As noted elsewhere within this response, there are certain sections of the standard, including within the application guidance, which we believe could be enhanced with additional guidance.

Specific Questions

Question 4

Do you support the eight components and the structure of ED-ISQM 1?

Response

We support the eight components and the structure of the ED-ISQM 1.

Question 5

Do you support the objective of the standard, which includes the objective of the system of quality management? Furthermore, do you agree with how the standard explains the firm's role relating to the public interest and is it clear how achieving the objective of the standard relates to the firm's public interest role?

Response

We support the objective of the standard, but in our view the standard could be improved by expanding on the definition of "reasonable assurance", which is a term that is integral to the objective of ED-ISQM 1.

The concept of "reasonable assurance" is included within paragraph 18 of ED-ISQM 1, and this paragraph, more widely, sets out the overall objectives of the standard. In practice, it will be important that firms adopt a consistent understanding of "reasonable assurance" but we are concerned that the definition of "reasonable assurance" in ED-ISQM 1 is too brief to allow for consistency. Consequently, we recommend the definition is expanded to reduce the risk of diverging interpretations and to promote consistent application.

Also refer to our response below to Question 12 (e), which further addresses our concerns regarding the concept of "reasonable assurance".

We agree with how the standard explains the firm's role relating to the public interest. In our view the standard is sufficiently clear, both explicitly and implicitly, as to how the objectives of the standard relate to the firm's public interest role and it strikes the right balance without being overly prescriptive in this regard.

Question 6

Do you believe that application of a risk assessment process will drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved? In particular:

- (a) Do you agree that the firm's risk assessment process should be applied to the other components of the system of quality management?*
- (b) Do you support the approach for establishing quality objectives? In particular:*
 - i. Are the required quality objectives appropriate?*
 - ii. Is it clear that the firm is expected to establish additional quality objectives beyond those required by the standard in certain circumstances?*
- (c) Do you support the process for the identification and assessment of quality risks?*
- (d) Do you support the approach that requires the firm to design and implement responses to address the assessed quality risks? In particular:*
 - i. Do you believe that this approach will result in a firm designing and implementing responses that are tailored to and appropriately address the assessed quality risks?*

- ii. *Is it clear that in all circumstances the firm is expected to design and implement responses in addition to those required by the standard?*

Response

We believe that the application of a risk assessment process will generally drive firms to establish appropriate quality objectives, quality risks and responses, such that the objective of the standard is achieved.

- a. We agree that the firm's risk assessment process should be applied to the other components of the system of quality management.
- b. We generally support the approach in ED-ISQM 1 for establishing quality objectives.
 - i. The required quality objectives are appropriate.
 - ii. We have a concern that the use of the word "expected" within this section of the standard may lead to different interpretations of its meaning. In our view, there may be circumstances, particularly for SMPs, for which additional quality objectives beyond those required by the standard, would not be necessary. For such firms, there is a risk that the phrase "is expected to" may be misinterpreted to mean "shall". Consequently, we believe that ED-ISQM 1 should use "may" rather than "is expected to", where it refers to the firm establishing additional quality objectives beyond those required by the standard. We believe this will also help with the scalability of the standard.

Additionally, the point on establishing additional quality objectives could be reinforced within each of the eight separate components of ED-ISQM 1, by repeating the guidance for firms on establishing additional quality objectives beyond those required by the standard in certain circumstances.

- c. In general, we support the process for identification and assessment of quality risks. However, there is a risk of different interpretations of the requirements relating to the starting point of the risk assessment process. This concern arises from:
 - the flow chart in paragraph 33 of Section 3 "Significant Matters", of the Explanatory Memorandum, which introduces the concept of the "whole population" of quality risks; and
 - paragraph 27 of ED-ISQM 1, which requires the firm to form an understanding of the factors which could adversely affect the achievement of quality objectives. Such an understanding under paragraph 27, is required to be gained by firms prior to applying the threshold test to identified risks, as set out in paragraph 28.

We believe that the concept of the "whole population" of quality risks (in a) above) and the open-ended nature of the understanding that needs to be formed under b) above, could each be subject to different interpretations. In our view, some parties using the standard, could interpret these two points as being a requirement on the firm to determine a comprehensive set of quality risks, for each quality objective, to which there

is no level of risk threshold. In other words, the “whole population” of risks could be interpreted as including every theoretical risk, no matter how trivial the risk may be.

If the standard is interpreted, as we have suggested above, this would not achieve the scalability objectives. Rather, it would lead to considerable extra effort for firms to identify every quality risk without any minimum level to their risk. Under this interpretation of the requirements, this “whole population” of risks would then be reduced after applying the risk threshold criteria in paragraph 28 of ED-ISQM 1.

Consequently, we believe the IAASB should revise the wording applied to the initial stage of identifying quality risks, to ensure that the requirements for the initial stages of the risk assessment processes, and specifically documentation requirements, are less ambiguous to interpret and that the final wording helps to promote the scalability of the standard.

- d. We support the approach that requires the firm to design and implement responses to address the assessed quality risks.
 - i. We believe that the approach will result in a firm designing and implementing responses that are tailored to, and which will appropriately address, the assessed quality risks. See however our comments elsewhere regarding prescribed responses which have been retained from extant ISQC 1. We believe that this approach negatively impacts the scalability objectives, but may also perpetuate some of the (perceived) issues with the current ISQC 1.
 - ii. It is generally clear within ED-ISQM 1 that the firm is expected to design and implement responses in addition to those required by the standard in certain circumstances. However, this point should be reinforced by including an additional paragraph within each of the eight separate components of ED-ISQM 1 which repeats the expectation for the firm to design and implement responses in addition to those required by the standard in certain circumstances.

More importantly, we have a concern that the use of the word “expected” within this section of the standard may lead to different interpretations in practice. There may be circumstances, particularly for SMPs, for which additional responses beyond those required by the standard, would not be necessary. For such firms, there is a risk that the phrase “is expected to” is interpreted to mean “shall”. Consequently, we believe that ED-ISQM 1 should use “may” rather than “is expected to”, or provide further guidance on what “expected to” means. We believe this will also help to scale the application of the standards.

Question 7

Do the revisions to the standard appropriately address firm governance and the responsibilities of firm leadership? If not, what further enhancements are needed?

Response

The revisions to the standard appropriately address firm governance and the responsibilities of firm leadership.

However, the standard contains inconsistencies in its requirements for periodic performance evaluations for those with ultimate and operational responsibility for the firm's system of quality management, specifically in context of an SMP firm. For example, in paragraph 24 (b) of ED-ISQM 1 there is a required response that a firm shall establish policies and procedures over the process for such an evaluation, without any exemptions from these requirements for a small firm. But the related application guidance in paragraph A42 of ED ISQM 1 indicates that the results of a firm's monitoring process may provide an indication of the performance of those with ultimate and operational responsibility for the firm's system of quality management, where it is impractical to perform performance evaluations.

The use of the word "may" in paragraph A42 of ED-ISQM 1 versus "shall" in paragraph 24 (b) of ED-ISQM 1, could lead to diverging views on how formalised an SMP's performance evaluation process should be for those with ultimate and operational responsibility for the system of quality management.

Question 8

With respect to matters regarding relevant ethical requirements:

- (a) Should ED-ISQM 1 require firms to assign responsibility for relevant ethical requirements to an individual in the firm? If so, should the firm also be required to assign responsibility for compliance with independence requirements to an individual?*
- (b) Does the standard appropriately address the responsibilities of the firm regarding the independence of other firms or persons within the network?*

Response

- a. We do not believe that the ED-ISQM 1 should require the firm to assign responsibility for relevant ethical requirements to an individual within the firm. Relevant ethical requirements and related ethical principles could in part be met through other elements of the quality management system (such as Resources). Assigning responsibility for ethical requirements broadly will simply not be practical or feasible.

We believe the narrower focus on independence should be retained. However, we suggest that firms should only be required to assign responsibility for compliance with independence requirements to an individual where independence has been identified as a risk (e.g. if firms do not perform any assurance or other work for which independence is required, this should not be a required response).

Firms who are subject to independence requirements generally invest significant resources into managing independence, and complex independence considerations often need to be considered by those with specialist knowledge. Where a risk to independence of such a nature has been assessed by a firm it therefore follows that overall responsibility should be assigned for independence.

This approach would also help with the scalability of the standard and would be particularly beneficial to SMPs that do not perform audit work.

- b. The standard appropriately addresses the responsibilities of the firm regarding the independence of other firms or persons within the network, through its principles-based requirements addressing relevant ethical requirements.

Question 9

Has ED-ISQM 1 been appropriately modernized to address the use of technology by firms in the system of quality management?

Response

Through its principles-based approach to technological resources, ED-ISQM 1 has been appropriately modernised to address the use of technology by firms in the system of quality management.

Question 10

Do the requirements for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders? In particular, will the proposals encourage firms to communicate, via a transparency report or otherwise, when it is appropriate to do so?

Response

The requirements in ED-ISQM 1 for communication with external parties promote the exchange of valuable and insightful information about the firm's system of quality management with the firm's stakeholders.

While these requirements may not be as relevant to smaller firms, the proposals are likely to encourage larger firms, or firms providing audit services to public interest or listed entities, to communicate via a transparency report.

Question 11

Do you agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review? In your view, will the requirements result in the proper identification of engagements to be subject to an engagement quality review?

Response

Except for the point noted below, we agree with the proposals addressing the scope of engagements that should be subject to an engagement quality review, and that the requirements will generally result in the proper identification of engagements to be subject to an engagement quality review.

However, the use of the term "entities that the firm determines are of significant public interest" in paragraph 37 e (ii) of ED-ISQM 1, may lead to confusion with other similar terms (such as "Public Interest Entities") that are commonly used by firms or may already be defined by regulators and other public oversight bodies in certain jurisdictions. Specifically, as noted in the Explanatory Memorandum, the use of the term "Entities that are of significant public interest" in

this ED and in the ISAs may raise questions as to how this relates to “public interest entity” as defined in the Code.

Consequently, we have a concern that the proposal to perform an EQR for “audits of financial statements of entities that the firm determines are of significant public interest” may result in inconsistent interpretations by firms and by regulators. As the terminology is used in existing ISAs we do not propose a change to the terminology in ED-ISQM 1. However, we recommend that paragraph 37 (e) in ED-ISQM 1 be amended to the effect that “entities that are of significant public interest” be included in the examples of entities that a firm should consider, rather than creating an explicit requirement for EQR around an ambiguous concept.

By way of example, in South Africa, “public interest entities” are defined by regulation, though not in the context of requiring an EQR to be performed but rather in the context of independence requirements. The proposed requirement in the ED may therefore be interpreted to mean that an EQR should be required for all such entities.

Question 12

In your view, will the proposals for monitoring and remediation improve the robustness of firms’ monitoring and remediation? In particular:

- (a) Will the proposals improve firms’ monitoring of the system of quality management as a whole and promote more proactive and effective monitoring activities, including encouraging the development of innovative monitoring techniques?*
- (b) Do you agree with the IAASB’s conclusion to retain the requirement for the inspection of completed engagements for each engagement partner on a cyclical basis, with enhancements to improve the flexibility of the requirement and the focus on other types of reviews?*
- (c) Is the framework for evaluating findings and identifying deficiencies clear and do you support the definition of deficiencies?*
- (d) Do you agree with the new requirement for the firm to investigate the root cause of deficiencies? In particular:*
 - i. Is the nature, timing and extent of the procedures to investigate the root cause sufficiently flexible?*
 - ii. Is the manner in which ED-ISQM 1 addresses positive findings, including addressing the root cause of positive findings, appropriate?*
- (e) Are there any challenges that may arise in fulfilling the requirement for the individual assigned ultimate responsibility and accountability for the system of quality management to evaluate at least annually whether the system of quality management provides reasonable assurance that the objectives of the system have been achieved?*

Response

In our view the proposals for monitoring and remediation will generally improve the robustness of firms’ monitoring and remediation.

- a. In order that the proposals are more likely to support an improvement in firms' monitoring of the system of quality management as a whole, we recommend that this component of ED-ISQM 1 makes explicit reference to "system of quality management as a whole". This may reduce the risk of some firms misinterpreting this requirement as being applicable only to the monitoring of engagements, rather than being applicable to monitoring all components of the system of quality management.

Other than this recommendation, in our view the proposals will promote more proactive and effective monitoring activities, including the development of innovative monitoring techniques.

- b. We agree with the IAASB's conclusion to retain the requirement for the inspection of completed engagements for each partner on a cyclical basis.

We also agree with the enhancements in the standard to improve the flexibility of the requirement and the focus on other types of reviews. However, the standard would benefit from additional guidance on in-process reviews, including guidance on how the firm should determine the appropriate mix of both in-process and completed engagement reviews.

ED-ISQM 1 does not go far enough in promoting scalability for this component. We believe that scalability is highly relevant to monitoring activities, given firms' circumstances can vary significantly. Consequently, we recommend that the IAASB reconsiders where it can introduce more scalability into this component of the standard.

- c. The framework for evaluating findings and identifying deficiencies is helpful and we believe that it is appropriate for its inclusion within ED-ISQM 1.

However, to promote consistency of interpretation, the proposed wording could be made clearer by including a definition of, plus supplementary application guidance on, the term "finding". This term is a critical aspect of the monitoring process, and it is used frequently throughout the ED-ISQM 1 but it is not defined.

- d. We agree with the new requirement for the firm to investigate the root cause of deficiencies.

i. We also agree with the requirements on the nature, timing and extent of procedures to investigate the root cause.

ii. Additionally, we agree that the manner in which ED-ISQM 1 addresses positive findings is appropriate.

- e. The key challenge that may arise in fulfilling this requirement, is regarding the term "reasonable assurance". This term is not adequately defined in ED-ISQM 1 and there is a risk that it may be subject to varying interpretation.

Consequently, we recommend that further clarification be included within the standard to provide a better definition of "reasonable assurance".

Additionally, we believe the following excerpt from paragraph 18 of the Explanatory Memorandum to ED-ISQM 1 would be useful if included in the main body of the proposed standard:

“In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (i.e., in the case of an assurance engagement). Instead, reasonable assurance is obtained through the operation of the system as a whole.”

Par. 67(c)(v) requires that the firm document “The basis for the evaluation of whether the system of quality management provides reasonable assurance that the objectives ... have been achieved”, while there is no further guidance either in the body of the proposed standard or in the application material. Additional guidance on the nature of the process that a firm should undertake in order to gain reasonable assurance is required.

Question 13

Do you support the proposals addressing networks? Will the proposals appropriately address the issue of firms placing undue reliance on network requirements or network services?

Response

We support the proposals addressing networks. In our view, the proposals will help to address the issue of firms placing undue reliance on network requirements or network services.

Question 14

Do you support the proposals addressing service providers?

Response

We support the proposals addressing service providers. However, we encourage the IAASB to emphasise the impact of the proposed requirements in its outreach activities. Firms would need to communicate the need and secure the support of their service providers to ensure that the necessary information will be provided by such service providers for the firm to comply with the proposed requirements.

Question 15

With respect to national standard setters and regulators, will the change in title to “ISQM” create significant difficulties in adopting the standard at a jurisdictional level?

Response

The change in title to “ISQM” will not create significant difficulties in adopting the standard at a jurisdictional level.

Glossary of terms

ED-ISQM 1	Exposure draft February 2019: International Standards on Quality Management 1
ISQC 1	International Standards on Quality Control 1
IAASB	International Audit and Assurance Standards Board
SMP	Small and medium-sized practitioners
EQR	Engagement Quality Review
ISA	International Standards on Auditing