



30 April 2013

Mr James Gunn
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, NY 10017

Dear James,

AUASB Submission on Consultation Paper
A Framework for Audit Quality

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to have the opportunity to comment on the IAASB Consultation Paper *A Framework for Audit Quality* (“the Framework”).

The AUASB commends the IAASB’s initiative to develop the Framework at a time when the delivery of a high quality, robust, and independent audit is viewed as a critical cornerstone of credible financial reporting. The AUASB supports initiatives that are in the public interest and that seek to enhance the quality of the audit process and reinforce confidence of capital markets in that process.

The AUASB considers aspects of the Framework to be a summary of current principles and requirements already contained in International Auditing Standards (ISA’s) particularly ISA 220 *Quality Control for an Audit of Financial Statements* and International Standard on Quality Control (ISQC) 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements*. In addition, the AUASB considers that the inclusion of “Key Interactions” and “Contextual Factors” is essential to an overall understanding of audit quality and commends the IAASB on their initiative of including these elements in the Framework. Overall, the AUASB considers the Framework as a useful document that reinforces existing principles whilst expanding their perspective to include the role of all stakeholders in the financial reporting supply chain.

In formulating its response, the AUASB has sought input from its constituents in several ways. The first was by way of hosting two roundtable meetings with stakeholders that represented a broad range of backgrounds including assurance providers from all sized firms, audit regulators, professional accounting bodies, board audit committees, preparers (CFOs) and institutional investors. The second was by way of a subsequent formal discussion by the AUASB members; and the third was by an open invitation to comment placed on the AUASB website with an accompanying notification sent to subscribers.

The stated objectives of the Framework are to:

- (a) Raise awareness of the key elements of audit quality;
- (b) Encourage key stakeholders to explore ways to improve audit quality; and
- (c) Facilitate greater dialogue between stakeholders on the topic.

The AUASB considers that the first and third objectives above have been met. The encouragement of key stakeholders to explore ways to improve audit quality is an ongoing process that the AUASB trusts is underway, and the AUASB is of the view that should some or all of the suggestions in this submission be addressed, this second objective may be more readily achieved.

The AUASB raises the following points of particular importance for the IAASB's consideration:

1. The Framework describes that a **quality audit** is likely to be achieved when the auditor's opinion on the financial statements can be relied upon as it was based on sufficient appropriate audit evidence obtained from an engagement team that:
 - (a) exhibits appropriate values, ethics and attitudes;
 - (b) is knowledgeable and experienced;
 - (c) applies quality control procedures;
 - (d) provides valuable and timely reports; and
 - (e) interacts appropriately with stakeholders.

The AUASB notes that there is no actual definition of the term '**audit quality**' in the systemic sense, nor of a **quality audit**, included within the Framework and encourages the IAASB to formulate and include appropriate definitions for both terms and the relationship between the two. The AUASB recognises that a universally acceptable definition focusing on either aspect of audit quality may be difficult to establish. Some of our constituents prefer a "narrow" definition of a quality audit, which focuses on whether the auditors obtained sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base their opinion, the likelihood that the audit detects material misstatements, and if found whether the auditor acts upon it.

2. **Audit quality** is described by various attributes as articulated by the Framework. Indeed, a **quality audit** will be best achieved when the attributes of the Framework perform at their optimal levels. A quality audit will be influenced by the extent to which the attributes are performing at their optimal levels.

In providing a quality audit, auditors need to identify and respond to the Contextual Factors that may pose a threat to the auditor's performance. Accordingly, while the AUASB supports the elements as articulated in the Framework, a quality audit is more readily achievable when all the elements of the Framework are able to be implemented.

In view of the above, the AUASB recommends that the IAASB's Framework clearly defines and differentiates between the concepts of **audit quality** and a **quality audit** as early as possible in the Framework.

3. The description of a quality audit contained in the Framework does not explicitly include independence, professional scepticism or professional judgement as key attributes. The AUASB considers that given ISAs are principles-based, the exercise of professional judgement is fundamental to audit quality. Whilst the AUASB acknowledges that these attributes are included within the Framework as subsets to the description given in paragraph 1 above, owing to their significance, the AUASB encourages the IAASB to explicitly include independence, scepticism and professional judgement in the key attributes of audit quality and include them in the main body of the description.

4. The AUASB considers that the Framework, in its existing form, is somewhat lengthy to navigate, and draw out the criteria by which to assess audit quality. We consider that all areas of audit quality have been considered but that the Framework would benefit significantly by including a prioritised concise “summary of key matters to be considered” by stakeholder, so that user attention can be directly focused on the key elements that impact audit quality by stakeholder. Furthermore, the AUASB considers that it would be worthwhile for the Framework to include an Executive Summary that could contain the definitions of audit quality (or key attributes of audit quality), a quality audit as well as a “summary of key matters to be considered” by stakeholder. An Executive Summary could make the Framework more user friendly and increase the likelihood of practical application.
5. While the Framework includes audit quality considerations specific to audits of smaller entities, the AUASB considers the Framework to be primarily focused on audit services provided to public interest entities. The AUASB considers that audit quality is critical to all segments of the audit market to promote economic growth founded on consistent audit practices. The AUASB recommends that the IAASB ensures that the Framework can be adapted by professional bodies and national standard setters so that it can be more readily used by small to medium sized practitioners. Furthermore, the AUASB recommends that the IAASB clarifies whether the special considerations in relation to smaller entities currently included within the Framework relates to smaller business entities (SMEs) or to smaller audit firms (SMPs), which may not be the same. The AUASB recommends that these should be considered independently since they have different issues and may not necessarily be mutually exclusive.
6. The AUASB encourages the IAASB to clarify the positioning of the Framework within the “Structure of Pronouncements Issued by the IAASB” section of the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*. The AUASB recommends as part of the ISA implementation monitoring project that ISA 220 *Quality Control for an Audit of Financial Statements* and International Standard on Quality Control (ISQC) 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements* be reviewed in light of the Framework to ensure linkage and alignment between the Standards and the Framework, and make any refinements to the Standards considered necessary.

Our responses to the specific questions contained in the Consultation Paper are presented taking into consideration the views of our stakeholders where appropriate, and are outlined in **Attachment 1 and Attachment 2** to this letter for the IAASB’s consideration.

Should you have any queries regarding this submission, please do not hesitate to contact either myself at rmifsud@auasb.gov.au or Rene Herman at rherman@auasb.gov.au.

Yours sincerely,



Richard Mifsud
Executive Director

Attachments



practitioners, with no responsibility assigned to management and those charged with governance. The AUASB is of the view that the conduct of corporate management and those charged with governance in terms of values, ethics, attitudes and culture has a direct influence on the audit environment; as does the client's internal control structures and staff competencies. While these are included in the Framework, the AUASB considers that these should be given greater emphasis.

Constituents made the following comments for consideration by the IAASB:

- Constituents believe that the Framework needs to differentiate between the knowledge requirements of audit executives (e.g. partners and managers) and staff.
- Constituents consider that the balance of responsibility is dependent upon the specific circumstances of an assurance engagement, and that ultimately the skill of the auditor needs to be matched to the particular needs of a client and engagement circumstances.
- Constituents consider that the roles of management and those charged with governance affect the audit environment and need to be given greater prominence within the Framework.

Q3 How do you intend to use the Framework? Are there changes that need to be made to the form or content of the Framework to maximise its value to you?

Response:

Should some or all of the AUASB's suggestions in this submission be addressed, the AUASB considers the likely primary uses of the Framework to be:

- (a) A reference document for assurance practitioners (particularly smaller firms) to assess whether they have achieved all elements required to undertake a quality audit;
- (b) A useful, accessible, concise summary of key matters for audit committees to consider when assessing the quality of audits undertaken for their entity and audit quality overall;
- (c) Beneficial for educational and training purposes;
- (d) National Regulators as a reference point for monitoring programs; and
- (e) Background for academic research.

Additionally, constituents commented on the following:

- *Refer paragraphs 3 and 4 under matters for the IAASB's consideration included in the cover letter.*
- In relation to considerations specific to public sector audits, the AUASB recommends that the Framework explicitly recognises that public sector audit bodies may have no choice or discretion in relation to engagement acceptance and continuance.
- Constituents were concerned that the Framework may drive a checklist mentality to which existing Frameworks developed by audit firms may be reconciled; but that



Attachment 1

Responses to Specific Questions listed in the Consultation Paper

Q1 Does the Framework cover all of the areas of audit quality that you would expect? If not, what else should be included?

Response:

Yes, the AUASB considers that the Framework covers all the expected areas of audit quality.

Additionally constituents commented on the following:

- *Refer paragraphs 1, 2, 3 and 4 under matters for the IAASB's consideration included in the cover letter.*
- The Framework does not specifically include the core audit process as a separately identifiable element within the Framework and accordingly, constituents believe that the IAASB has undervalued the core audit process. The AUASB recommends that the Framework uses the terminology "Inputs and Audit Process" rather than "Inputs"; alternatively the AUASB recommends that the IAASB draws the audit process out of "Inputs" and includes it as a standalone element within the Framework to reinforce its value. Similarly, the diagram could make explicit reference to the audit process.
- The AUASB welcomes the introduction of the Key Interactions element into the Framework and commends the IAASB on this initiative. However, constituents consider that the framework does not sufficiently focus on global interactions between global auditors and global management/those charged with governance. Audit inspection reports in Australia have noted audit quality matters in relation to the evaluation and use of component auditors' work. While the Framework does address this area, the AUASB recommends a greater focus and more guidance given in relation to global interactions.
- Constituents and the AUASB would like to see additional guidance for situations whereby management may exert undue influence on the auditor selection process and audit fee negotiations thereby causing an inherent independence threat.

Q2 Does the Framework reflect the appropriate balance in the responsibility for audit quality between the auditor (engagement team and firm), the entity (management and those charged with governance), and other stakeholders? If not, which areas of the Framework should be revised and how?

Response:

No, constituents and the AUASB are of the view that more weight could be given to management and those charged with governance within the Framework. The AUASB considers that the Framework may be used effectively by auditors to evaluate whether they had undertaken a quality audit but other stakeholders may have difficulty in using the Framework to understand whether they have discharged their responsibilities in a way that facilitates the achievement of audit quality. Constituents commented that the description of a quality audit contained in the Framework is weighted only towards audit



there might be no advance to audit quality. The AUASB considers that by prioritising the key attributes of a quality audit, this may drive a change in audit focus, thereby ultimately improving audit quality overall. The AUASB suggests a “concise summary of key matters to be considered” by stakeholder, and in that way making the Framework more user friendly and increasing the likelihood of practical application.

- In jurisdictions such as Australia, where Auditing Standards are legally enforceable for audits of some entities, for the Framework to have optimum use in setting out the principles of audit quality and its key drivers, the AUASB considers that it may need to be established as an authoritative reference and be included within the suite of auditing standards. The AUASB does not consider this achievable given the Framework’s current form for the reasons outlined previously. An alternative may be to include the document in the IAASB Handbook as a useful reference and ensure that it is not overlooked.

Q4 What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?

Response:

Refer Attachment 2



Attachment 2

Views on Suggested Areas to Explore: What are your views on the suggested Areas to Explore? Which, if any, should be given priority and by whom? Are there additional Areas to Explore?

1. Establishing global guidance against which audit firms can assess their governance arrangements.

Views:

The AUASB considers audit firm and engagement governance to have a significant influence on audit quality and therefore in principle supports the establishment of global guidance against which audit firms can assess their governance arrangements. The AUASB believes that issuance of global guidance increases consistency and comparability, which increases usefulness of information to regulators, investors and audit committees (responsible for auditor selection).

Constituents made the following comments for consideration by the IAASB:

- Global guidance may have an adverse impact on the ability of mid-tier and smaller firms to remain in the audit services market in the long-term. The AUASB considers that a diverse profession is essential to providing high quality audit services to all segments of business.
- Some constituents did not consider the IAASB to be the appropriate body for issuing such global guidance and considered that governance specialists should be responsible.
- Global guidance would be difficult to establish practically since the majority of audit firms do not only offer audit services. A governance framework applicable to only audit services may not be applicable to an entire firm.
- Constituents were of the view that transparency of firms' governance arrangements should be encouraged rather than mandated.

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.

Views:

The AUASB acknowledges that auditing is seen as a highly skilled, specialised, knowledge-based service industry where the experience of assurance practitioners is of critical importance and is a key driver of audit quality.

The AUASB considers that the Framework is a useful addition that summarises the key capabilities and competencies required of auditors. However they are already emphasised via International Education Standard IES 8 *Professional Development for Engagement Partners Responsible for Audits of Financial Statements*, which addresses competency requirements for audit professionals. Similarly the registration process for auditors in different jurisdictions may well involve meeting an agreed level of competency, and IESBA 110 *Code of Ethics for Professional Accountants* sets out that all professional accountants must comply with the fundamental principles of professional



competence and due care.

Constituents felt that audit firms require a level of autonomy in relation to recruiting, evaluating, promoting and remunerating staff, and that owing to cultural differences, firm structures, outsourcing and use of lower cost service entities (offshoring) that any consistent understanding of staff capabilities may be impractical to implement or assess.

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

Views:

The AUASB considers that limited information sharing between audit firms of relevant information is beneficial, but that the extent of such sharing should be limited to that information considered necessary to enable the incoming auditor to form a basis of reliance on opening balances.

In many jurisdictions such as Australia, stringent independence laws and regulations are in place to ensure auditor independence, which is considered as paramount to audit quality. The AUASB considers that sharing too much information could defeat the purpose of a change in auditor in that the successor auditor's knowledge is framed from the view of the predecessor auditor.

4. Considering whether audit inspection activities can do more to improve audit quality and to make audit quality more transparent to users.

Views:

The AUASB supports greater transparency and timely balanced reporting in relation to the results of inspections of audit firms.

In many jurisdictions, the regulators perform audit inspection activities and communicate the inspection findings to the firms involved. Various public reports containing key inspection observations and findings are also produced, with or without publically identifying the firms or audited entities involved.

The ability for regulators to communicate directly with senior management of the audited entity, the board of directors and the audit committee when relevant and particular information on audit or accounting issues are identified is also a useful tool for regulators.

The AUASB considers that the possibility of public disclosure of some or all portions of inspection reports would provide strong incentives for an audit firm to make improvements to its audit quality process. Furthermore, the AUASB considers three-way communications between regulators, audit firms and standard-setters are essential in the audit quality improvement process.

Constituents commented that to improve audit quality and make it more transparent to users, including positive findings in audit inspection reports would be as beneficial as reporting adverse findings as they provide valuable, transparent information on when a quality audit has been undertaken.



5. Exploring whether there would be value in national authorities responsible for determining sanctions on auditors exchanging information with a view to evaluating the relative effectiveness of their different arrangements.

Views:

The AUASB supports in principle exploring the idea of whether there would be value in national authorities exchanging information as this could improve transparency, knowledge and consistency across national authorities. The AUASB acknowledges that this would be difficult to implement in practice as different national authorities generally operate different models with different stakeholders and requirements.

With many medium and larger audit firms operating across many different national borders, the AUASB considers there is a need for an effective global auditor oversight function. In some jurisdictions, the regulators have sought to minimise the regulatory burden on National audit firms by seeking arrangements with other international audit oversight bodies so as to conduct inspection work either jointly or on their behalf.

6. Considering ‘root causes’ and best practices by regulators, audit firms, and the wider audit profession in order to learn from past audit deficiencies and to identify and address systemic issues.

Views:

The AUASB strongly supports the consideration of ‘root causes’ and best practices by regulators, audit firms, and the wider audit profession in order to learn from past audit issues and deficiencies, and to identify and address any systemic issues. The AUASB considers that this could best be done by global academic research into any interplay between corporate collapses and audit failures. The AUASB considers that regulators may be the most suitable bodies to undertake such research owing to the significance of confidentiality and the extent of their own analysis and records.

7. Increasing the informational value of auditor’s reports and improving perceptions of the value of the audit.

Views:

The AUASB’s response to this Area to Explore is contained in the AUASB’s previous response to the IAASB’s Invitation to Comment *Improving the Auditor’s Report*, dated 12 October 2012. In summary the AUASB supports:

- Communicating Key Audit Matters (Auditor Commentary) concept in principle.
- The relocation and revised wording in the opinion and basis for opinion paragraphs.
- The enhancements to improve user understanding, particularly of responsibilities of the respective parties.
- The consolidation of information in the Basis for Opinion paragraph.
- Global consistency through mandating minimum requirements and encouraging



national tailoring (the “building blocks approach”).

- Going Concern reporting, with appropriate changes to the financial reporting framework.

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

Views:

The AUASB supports improving two-way communication between auditors and financial and prudential regulators with a view to understanding key risks or areas of focus of the regulator, improving transparency, and knowledge of the audit process and its outcomes.

This may already exist in some jurisdictions. For example, the financial services sector in Australia is well regulated and communications within the industry amongst practitioners, financial institutions, regulators and standard- setters currently occurs in both a formal and ‘informal’ way. For special purpose engagements under *Australian Prudential Regulation Authority (APRA) Standards*, there are mechanisms in place for tripartite arrangements involving the auditors, the financial institution and the Australian Prudential Regulation Authority (APRA) whereby any party involved in the tripartite relationship may initiate meetings or discussions at any time as considered necessary. Notwithstanding tripartite relationships, APRA and the auditor may meet, at any time, on a bilateral basis at the request of either party for whatever reasons are considered appropriate. In addition, the “Big-4” accounting firms and the AUASB have regular auditor liaison meetings with APRA to share and resolve audit related issues.

9. Striving for greater international harmonisation in the role of audit committees with regard to the evaluation of the quality of the external audit.

Views:

The AUASB considers it worthwhile to strive towards greater international harmonisation in the role of audit committees with regard to the evaluation of the quality of the external audit. The AUASB however, considers that this may prove difficult owing to the limitation that many countries do not have established rules in respect of the conduct and operation of audit committees. The nature of the business, the regulatory environment, ownership structure, legal requirements and audit committee membership influence the objectives and activities of an audit committee.

The AUASB would want to avoid regulation leading to an overly prescriptive rules type approach.



10. Encouraging audit committees to provide more information to users of the financial statements on the work they have undertaken, the main issues they have addressed, and the reasons for their conclusions.

Views:

The AUASB supports audit committees providing more transparent reporting as it is in the public interest for investors/markets, regulators and other users to have access to more information about the audit process.

Constituents made the following comments for action to be considered by the IAASB:

- Audit committees vary in size and degree of sophistication; thus, in a global context, constituents believe that there may be greater opportunity to enhance audit quality through auditors providing augmented auditor commentary on the work undertaken, issues encountered and resolution of such matters than through an audit committee's commentary on these items.
- Entities have different risk profiles and constituents were therefore concerned that users of audit committee reports may view the absolute number of issues raised as an indication of the entity's internal control environment.
- Some constituents considered that the financial statements should contain the information necessary for users to make informed decisions. In addition, if reporting by audit committees was required this could result in reports being 'boilerplate' and therefore not contribute to improving audit quality.
