

May 15, 2013

Arnold Schilder, Chairman  
International Auditing and Assurance Standards Board  
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**Re: Request for Public Comment: IAASB Consultation Paper, A Framework for Audit Quality**

Dear Chairman Schilder:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA).

The CAQ appreciates the opportunity to respond to the International Auditing and Assurance Standards Board (IAASB) Consultation Paper, *A Framework for Audit Quality* (the Framework). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ shares with the auditing profession, financial statement preparers, those charged with governance, regulators, and others the goal of continuously strengthening audit quality. We commend the IAASB for the thoughtful content put forth in the Framework and the related outreach to those within the financial reporting supply chain to further inform the IAASB's thinking in this important area.

The IAASB's development of a framework for audit quality correlates with related efforts underway in the United States. For instance, the Public Company Accounting Oversight Board (PCAOB) has initiated a project to identify audit quality measures.<sup>1</sup> We believe it is important to establish a common vision of audit quality and encourage the IAASB to continue to consider the views of other standard-setters and regulators (e.g., PCAOB, the Securities and Exchange Commission (SEC)) in order to develop a holistic global view of audit quality. Towards that end, the CAQ is pursuing a project to consider the definition and indicators of audit quality and stands ready to assist the IAASB to further develop thinking around audit quality.<sup>2</sup>

<sup>1</sup> "Public Company Accounting Oversight Board Strategic Plan: Improving the Relevance and Quality of the Audit for the Protection and Benefit of Investors 2012 – 2016" (November 30, 2012) and "Standing Advisory Group, Audit Quality Indicators Briefing Paper" (May 15 - 16, 2013).

<sup>2</sup> CAQ letter to the PCAOB is available at: <http://www.thecaq.org/publicpolicy/pdfs/CAQAuditQualityLettertoPCAOBMay13-2013.pdf>.

As described more fully below, we have certain overall observations that we believe will enhance the Framework and have organized these observations and comments as follows:

- Intended Use of the Framework
- Completeness and Balance
- Suggested Areas to Explore

## **INTENDED USE OF THE FRAMEWORK**

The CAQ understands and supports the IAASB's objectives of the Framework to facilitate greater dialogue amongst stakeholders on the topic of audit quality and not establish additional standards or provide procedural requirements for audit performance. We observe, however, that the IAASB intends to include the Framework, once finalized, within the IAASB's listing of authoritative pronouncements,<sup>3</sup> and question whether this approach may give the impression that the Framework is more authoritative than is intended. Therefore, we recommend that the IAASB categorize the Framework consistent with its intended purpose, as a tool to facilitate discussion on the topic of enhancing audit quality.

The CAQ also believes that stakeholders would benefit from clarification regarding the steps the IAASB intends to take subsequent to publication of the Framework, particularly as it relates to how the IAASB plans to educate stakeholders regarding the Framework's content and usability.

## **COMPLETENESS AND BALANCE**

The CAQ supports the IAASB's inclusion of both input and output factors within the Framework. Moreover, we believe approaching audit quality at the engagement, firm, and national level, enhances the relevance of the Framework and allows for a variation of stakeholder uses. While we support the structure of the Framework, we believe the Framework could be enhanced in the following areas:

- **Audit Quality Definition**

While the Framework acknowledges the challenges of defining audit quality, it also includes dialogue within the Chairman's Foreword and paragraph 18 that may be interpreted as characteristics of audit quality. While many of the characteristics listed within these sections can contribute to audit quality, we are concerned that these characteristics could imply that audit quality requires auditor performance beyond what is required by auditing standards. Therefore, we recommend that the IAASB consider clarifying these statements (i.e., the Chairman's Foreword and paragraph 18) to avoid any misinterpretations by users of the Framework.

As part of the CAQ's audit quality project, we are exploring the benefits of developing an audit quality, and believe a definition of audit quality should:

1. Recognize the role that the audit committee plays in providing oversight of the audit services, and how this oversight contributes to enhanced confidence in the financial statements.
2. Incorporate the following key components, which we believe are critical to audit quality:
  - a. Compliance with the applicable regulations and professional standards.
  - b. Consideration of the audit firm's system of quality control, which is designed to consistently deliver quality audits in a dynamic and evolving environment.
3. Provide linkage to the key elements of an audit quality framework (e.g., value, ethics, and attitude; knowledge, experience, and time; process and execution; and reporting and communications).

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<sup>3</sup> Page 3, "Status and Placement of the Framework," Audit Quality – Summary and Disposition of Comments, IAASB Meeting (December 10–13, 2012) Agenda Item 2-C.

While we recognize the difficulty of establishing a uniform or singular definition, we believe the development of such a definition could provide a significant benefit to enhancing stakeholders' understanding of the role of the audit.

- **Interactions within the Financial Reporting Supply Chain**

The CAQ commends the IAASB for recognizing that, while the responsibility for performing an audit rests with auditors, audit quality is best achieved in an environment where there is support from other participants within the financial reporting supply chain (e.g., management, those charged with governance, regulators, and accounting and auditing standard-setters).<sup>4</sup> However, many of the key interactions between auditors and these participants are not acknowledged until later in the Framework, which may not appropriately convey the importance of such interactions. In order to more prominently convey the critical influence that all participants within the financial reporting supply chain have on audit quality, we suggest that the Framework highlight the importance of interactions among stakeholders, and the contextual factors of these interactions, prior to describing audit input and output factors. We believe highlighting earlier in the Framework (e.g., expanding paragraphs 26 through 29) the profession's interaction with others in the financial reporting supply chain will provide further context of the influences other supply chain participants have on inputs and outputs relating to audit quality.

- **Contextual Factors**

With respect to the discussion of contextual factors, it is important to articulate within the Framework the distinction between audit quality and financial reporting quality. In particular, the Framework should acknowledge, and articulate, that the preparer and its audit committee are primarily responsible for the quality of an entity's financial reporting, and the auditor is primarily responsible for the quality of the audit.

We also believe it is important that the Framework consider the impact standard-setting activities may have within an audit quality framework (e.g., a new accounting pronouncement or auditing standard may require new, or enhance existing, processes that could foster improved financial reporting and audit quality). Accordingly, we recommend that the IAASB also consider incorporating this element into the Framework.

- **Evergreen Document**

The CAQ understands that the Framework is intended to be 'evergreen,' written in a manner that maintains its relevance and usability over time, notwithstanding the changes within or outside the profession. We believe it is inevitable that changes will occur (e.g., issuance of new accounting and/or auditing standards) that will require enhancements, or amendments, to maintain the Framework's relevance and usability. Therefore, we recommend the IAASB clarify the process it will follow to update the Framework to reflect such changes.

The CAQ also notes that the Framework includes commentary on specific topics currently being discussed by regulators,<sup>5</sup> but lacks clarity regarding the relevance of inclusion and how these topics should be viewed by stakeholders in the context of audit quality. Considering the Framework's evergreen focus, we question whether these topics may inhibit the Framework's long-term relevance and usability and encourage the IAASB to reconsider whether these topics are appropriate for inclusion.

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<sup>4</sup> Page 4 of the Framework.

<sup>5</sup> For example, paragraph 41 – auditor rotation and paragraph 78 – partner identification.

- **Audit Efficiency / Audit Effectiveness**

Section 1.7.4 of the Framework identifies audit efficiency as an attribute of audit quality, particularly in the context of arrangements with management to achieve audit efficiency. While the pursuit of audit efficiency is worthwhile, this section of the Framework does not appear to articulate the importance of audit effectiveness in the context of these arrangements. We believe audit effectiveness is a key attribute of audit quality and encourage the IAASB to consider clarifying this section to ensure this is clearly emphasized. Moreover, we believe it would be helpful to clarify within the Framework the distinction between audit effectiveness and audit efficiency.

- **Laws and Regulations**

The Framework describes the impact laws and regulations can have on the quality of financial reporting.<sup>6</sup> However, legal environments can vary greatly between jurisdictions and geographical locations. This could have a significant impact on audit quality. For example, the rights of individuals and corporations, the consistent application of the law, and the objectivity of judicial proceedings may individually, or in concert, have an impact on the practice of auditing and the related quality of audits performed in that jurisdiction. Therefore, we suggest that the IAASB contemplate expanding the Framework to explicitly consider the impact of differing legal environments on audit quality.

- **Professional Licensing Framework**

The Framework acknowledges the profession's endeavors to provide auditors with the necessary skills and competencies through professional technical training (e.g., continuing professional development requirements).<sup>7</sup> However, the Framework appears to lack a discussion around the profession's licensing requirements and global variability (i.e., requirements may differ depending on the jurisdictions and geographical locations). We believe these licensing requirements are the foundation of the profession's training and development framework, and stakeholders should be educated to the rigors of obtaining, and maintaining, such licenses. Therefore, we recommend the IAASB update the Framework to include a discussion around the robustness and global variability of the profession's licensing requirements.

- **Supervision and Review**

We believe the Framework appropriately identifies direction, supervision, and review of "on-site" audit work as a key attribute to audit quality.<sup>8</sup> The Framework also discusses electronic supervision and review in the context of assessing "off-site" audit work.<sup>9</sup> However, the Framework appears to focus on articulating the challenges, as opposed to the benefits, of "off-site" supervision and review within an electronic environment. We believe there are benefits to working within an electronic environment, most notably timely review and feedback, particularly on audits that encompass engagement teams in different geographical locations. Further, with the increasing use of electronic means of communication, the profession's leveraging of electronic tools to direct, supervise, and review "off-site" audit work will only increase. To provide better balance to this discussion, we recommend that the IAASB enhance the Framework to consider both the benefits and challenges of directing, supervising, and reviewing audit work within an electronic environment.

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<sup>6</sup> Section 4.2, "Laws and Regulations Relating to Financial Reporting."

<sup>7</sup> Section 1.6.2, "Education Requirements are Clearly Defined and Training is Adequately Resourced."

<sup>8</sup> Section 1.4.5, "Staff Performing Detailed 'On-Site' Audit Work have Sufficient Experience, Their Work is Appropriately Directed, Supervised and Reviewed, and there is a Reasonable Degree of Staff Continuity."

<sup>9</sup> Paragraph 124 of Section 1.8.3, "The Methodology Requires Effective Supervision and Review of Audit Work."

## SUGGESTED AREAS TO EXPLORE

The IAASB has identified a number of areas for consideration by both auditors and other participants in the financial reporting supply chain that may ultimately impact audit quality. However, we believe more clarity is needed as to how the IAASB intends to examine each area under consideration. For example, it is unclear whether the IAASB intends to develop separate working groups for each area under consideration and if so, the composition of these working groups. We believe many of these areas under consideration require significant resources to develop a holistic global view, and we encourage the IAASB to prioritize its efforts in areas that are most impactful to the current auditing environment, which we believe are:

- **Root Causes and Best Practices** – The CAQ believes that “root cause” analyses are critical in educating the auditing profession, those charged with governance, and others in the financial reporting supply chain regarding the underlying reasons for past audit deficiencies; and enabling the identification and remediation of systemic or other issues affecting audit quality. For instance, an analysis of audit deficiencies could reveal the need for enhancements to audit policies and procedures, which could lead to enhanced audit quality.

Moreover, “root cause” analyses could assist standard-setters in setting their agendas. For example, an analysis of audit deficiencies could reveal trends in deficiencies or areas of improvement related to particular accounting and auditing standards. This could identify areas where guidance might be needed, whether in the form of interpretive guidance or a formal standard-setting project.

In this context, the CAQ supports and stands ready to assist, as appropriate, the IAASB in a collective effort to consider the root causes of audit deficiencies in order to identify and address systemic or other issues effecting audit quality. Moreover, we also support the identification of representative “best practices” that could provide context into the positive steps taken by the profession in improving audit quality.

- **Enhancing the Role of the Audit Committee** – Audit committees serve an essential role in the capital markets by protecting investors through their oversight of a company’s financial reporting process, including the hiring and oversight of the external auditor. The CAQ supports pursuing greater international harmonization and enhancing the role of the audit committee, particularly as it relates to the evaluation of the external auditor. To this end, the CAQ has collaborated with a number of U.S. governance organizations that provide education and support to audit committees to explore ways to strengthen audit committees of publicly traded companies. In October 2012, the CAQ and its collaborative partners released a new tool, *Audit Committee Essentials: The Annual Auditor Assessment*,<sup>10</sup> designed to be used by audit committees in their external auditor review and appointment process.

The CAQ also supports greater transparency by audit committees, although we are sensitive to the need to maintain the confidentiality of certain information proprietary to the company. Thus, we support further exploration of additional information audit committees might share with financial statement users about their activities in overseeing the financial reporting process. This additional transparency would help to promote accountability across audit committees; inform other audit committees about emerging best practices; and improve stakeholder confidence in the important role of the corporate governance system more generally, and audit committees specifically.

- **Improving the Auditor’s Report** – The CAQ is supportive of efforts to enhance the auditor’s reporting model to better meet the evolving needs of financial statement users and has previously shared views on this topic in comment letters to both the IAASB and the PCAOB.<sup>11</sup> Consistent with views shared in those letters, we continue to support further transparency in the auditor’s report with respect to clarifying certain language

<sup>10</sup> Publication is available at: <http://www.thecaq.org/resources/pdfs/AuditorAssessment.pdf>.

<sup>11</sup> CAQ comment letters to the IAASB dated March 14, 2013, October 8, 2012 and September 15, 2011 and the PCAOB dated September 30, 2011 and June 28, 2011. Available at: <http://www.thecaq.org/resources/commentletters.htm>.

within the auditor's report and enhancing auditor reporting in the form of required emphasis paragraphs to highlight certain disclosures in the financial statements. However, we caution against providing information which may exacerbate expectation gaps. The CAQ applauds the IAASB on the outreach it has conducted through its Invitation to Comment, *Improving the Auditor's Report* and the related roundtables, and believes that additional outreach is critical in considering ways to increase the information value of the auditor's reports.


Outside the 'areas to explore' as detailed within the Framework, we also believe that greater focus should be placed on continuous stakeholder education, to enhance the understanding of the objectives of an audit and narrow the information and expectation gaps. The CAQ believes key stakeholders should have a basic understanding of financial reporting requirements, trading and markets, and investor protection. This requires increasing efforts to expand educational outreach by utilizing traditional and emerging methods of communication and presenting information in a variety of formats that reach a range of audiences and age groups.

The CAQ produces numerous resources – from publications on relevant regulatory matters, to case studies, research surveys, and educational videos on the U.S. system of investor protection – that are designed to enhance stakeholder education of the financial reporting process. Although these resources are focused towards the U.S. system of investor protection, we believe they can be refined to adapt to other markets, and we encourage the IAASB to consider these tools in evaluating ways to enhance the educational needs of its stakeholders.

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The CAQ agrees with the importance of developing a holistic framework that can be utilized to facilitate greater dialogue amongst stakeholders on the topic of audit quality and appreciates the opportunity to comment on the Framework. We stand ready to assist the IAASB in further developing its thinking around audit quality and we welcome the opportunity to respond to any questions regarding the views expressed in this letter.

Sincerely,



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Executive Director  
Center for Audit Quality

cc:

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