

Mr. James Gunn
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

15 May 2013

Dear Mr. Gunn:

A Framework for Audit Quality

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the Consultation Paper, *A Framework for Audit Quality* (the Framework), issued by the International Auditing and Assurance Standards Board (IAASB). We support the IAASB's efforts in this Consultation Paper to bring further focus to the important topic of audit quality. In addition, we appreciate the IAASB's outreach on this project to the many stakeholders in the financial reporting supply chain, including investors.

We recognize and embrace our role and responsibility to serve the public interest by providing quality audit services in an independent and objective manner. Fulfilling this obligation is fundamental to instilling confidence in and providing credibility to the financial reporting that is central to the efficient functioning of the capital markets around the world.

Accordingly, we support the articulated objectives of the Framework and anticipate it will facilitate greater dialogue and exchange among stakeholders on this topic and encourage the exploration of the ways in which all participants can contribute to improving audit quality. The Framework has merits since it attempts to put forth a view of the many contributing factors and necessary interactions that contribute to and influence audit quality. As the demands on auditors change over time, the elements of audit quality and how they are viewed by stakeholders will likely further evolve. As such, enhancements to these elements may need to be reflected in the Framework.

To avoid any misunderstanding as to its intended purpose, we believe the IAASB must continue to emphasize to stakeholders that the objective of the Framework is only to raise awareness and facilitate greater dialogue between and among stakeholders. The Framework is not setting new standards or expectations but, rather, is intended to help articulate and visualize audit quality in the context of the International Standards on Auditing (ISAs) and ISQC 1.¹ It will be helpful and important for the IAASB to emphasize, through its outreach and educational efforts, that the Framework does not establish new requirements for the performance of audit engagements. A misunderstanding of the purpose of the Framework to this effect may have unintended consequences of widening the expectations gap.

¹ISQC 1, *International Standard on Quality Control 1*

General comments

Defining audit quality is complex and we support the IAASB's efforts to begin to describe a topic that does not have a universally-recognized definition or outcome. The Framework describes the many challenges with defining audit quality. While we recognize these challenges, we believe they reinforce the need for a definition that could serve as an important baseline and facilitate a better understanding of what audit quality means. A definition would also provide the foundation for the identification and use of key elements that contribute to a quality audit and assist in a more common understanding of those elements by all relevant parties and stakeholders in the audit process.

We note that paragraph 18 of the Framework provides a rather definitive view of how a quality audit is likely to be achieved, which may not be the same as the definition of audit quality. This paragraph suggests a definition of audit quality that may be confusing to users as there are a number of subjective phrases which may lead to varying interpretations of the key elements of audit quality as articulated in the Framework. It is important that any definition does not detract from the overarching objective of the Framework, which is to raise awareness of the key elements of audit quality.

Additionally, we have concern regarding the contextual factors element of the Framework², specifically with regard to how these factors are linked to the other elements of audit quality. The contextual factors currently are described in relation to their impact on the nature and quality of financial reporting, rather than linking them to the achievement of audit quality. We believe the Framework would benefit from a more direct connection of how the contextual factors affect the manner in which the audit is conducted and therefore how audit quality can be achieved.

Responses to the specific questions in the Consultation Paper for which the IAASB is seeking feedback are set out below.

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

The Framework aims to depict significant elements that contribute to audit quality. It demonstrates that, while auditors have the primary responsibility to execute a quality audit, there are many interactions and contextual and other factors that can and do have an influence on the achievement of a quality audit, many of which are beyond the control of the auditor. However, we believe the Framework could be enhanced with the inclusion of additional areas that we believe contribute to audit quality. We also suggest areas that could be more fully described or emphasized.

Additional areas of audit quality

Global integration – In today's global market, global integration is particularly important in the delivery of high-quality multinational audits, which often span multiple jurisdictions. Global integration facilitates sharing of knowledge and experiences from internal and external inspections across a global network, helps to increase consistency of performance and delivery of audit services and provides specialist resources to support engagement teams. We believe the

² Section 4 of the Framework

Framework would benefit from recognizing that globally integrated firms can help to address the challenges of international consistency in audit quality, notwithstanding differences in national jurisdictions and culture, through overall firm structure, policies, methodology and tools.

Integrated multidisciplinary service delivery - A multidisciplinary firm aligns the competencies and expertise throughout the organization to respond to the increasing complexity and sophistication of an audit. Teams that involve auditors as well as resources with specialized knowledge of valuation matters, information technology systems, taxes, actuarial science, derivatives and other fields assist in the execution of audit procedures, evaluation of management assumptions and critical accounting estimates, and documentation of judgments and decisions. Access to and effective integration of these specialist resources into the audit engagement team greatly enhances audit quality.

Commitment to continuous improvement - In an ever-changing world, audit quality requires a continuous focus on innovation and adaptation of audit procedures and techniques to maintain and enhance the objectivity, independence and professional skepticism that investors, regulators and other stakeholders expect from auditors. A process of continuous improvement can enhance the role and relevance of the auditor, which is not only in the public interest but is also beneficial to the audit profession as it assists in attracting and retaining talented individuals.

A commitment to audit quality means continuous improvement and investments in resources, training, tools and technology and the overall culture of audit firms. As the role of the auditor evolves and new techniques are introduced (such as, for example, the potential expanded use of data analytics), these investments are necessary to maintain audit quality.

Instilling professional values broadly - Setting the right tone at the top is a key responsibility of senior leadership of an organization, network or team and establishes for people that performing quality work and complying with professional standards are of paramount importance. The Framework recognizes that “tone at the top” is an input factor to audit quality,³ but only in the context of the firm’s adherence to ethical requirements. We believe the Framework should acknowledge the responsibility to communicate to professionals the importance of audit quality and more broadly, the significant role of the auditor in serving the public interest.

Relationship of accounting and auditing standards - Several inputs at the national level reflect the importance of ethical, educational and auditing requirements that apply to auditors⁴ but do not recognize the role of financial reporting frameworks – instead, the applicable financial reporting framework is only positioned as a contextual factor in the Framework. The growing complexity in the application of accounting standards, for example, with regard to financial instruments and the expanding use of fair value measurements, indicates the importance of timely development of new auditing standards or robust auditing guidance specific to an entity’s application of these increasingly complex accounting standards. Generally, we believe audit quality benefits from the consideration of the “auditability” of accounting standards as they are being developed. We believe the Framework could be enhanced by a more thorough description of how the complexity of financial reporting can affect the inputs and interactions that drive audit quality.

Additionally, the principles-based framework embedded in the accounting standards is commendable; however, if principles cannot be applied with reasonable consistency to similar

³ Section 1.2.1 of the Framework

⁴ Section 1.3.1, Section 1.6.2 and Section 1.9.1 of the Framework

fact patterns, the perceived value of such a framework is diminished and detracts from the value financial statement users place on the auditor's opinion in situations where the financial reporting framework results in multiple accounting options for a particular transaction. We understand that the IAASB does provide feedback to the International Accounting Standards Board during the development of proposed accounting standards, and we believe that such a liaison between auditing and accounting standard setters could be recognized in the Framework as a key interaction.

Additional suggestions for clarification or emphasis

We believe the Framework would benefit from clarification or emphasis with respect to several input factors as more fully described below. These clarifications are primarily focused on the fact that the way in which we conduct audits has changed in order to align with the current business environment of entities to which we provide audit services.

Benefits of technology-enabled audits - We believe the Framework appropriately identifies effective supervision and review⁵ and the engagement team's use of information technology,⁶ specifically the use of the audit firm's audit software, as input factors to audit quality. However, the Framework appears to focus on the risks to audit quality related to the use of such tools, such as enabling reviews from remote locations, and therefore, does not present a balanced view that includes the benefits of such tools. We believe these tools can enhance audit quality by facilitating team collaboration and communication whereby documentation and information can be shared in a secure peer-to-peer environment so that, regardless of geography, the engagement team can work together as if they were in the same location. Further, such tools can enable having audit methodology and related auditing standards at the fingertips of auditors. It is hard to imagine a high quality audit being conducted in a global environment without technology enablement.

We do not minimize the importance of on-the-job training and face-to-face discussions, but recognize that as both company management and audit engagement teams continue to span geographical boundaries, the effective use of information technology to enable the audit becomes more critical. Additionally, as audit firms employ strategies to leverage professionals and other resources cross-borders, policies and procedures can prescribe the nature of the work provided by these resources, and establish communication protocols and workpaper review procedures, all of which can be further enabled through the use of audit tools. These safeguards allow for effective use of cross-border resources while maintaining audit quality.

Audit methodology - We agree that a critical element to audit quality is a methodology that encourages engagement teams to apply professional skepticism and exercise appropriate professional judgment.⁷ Based on the requirements and guidance in the ISAs, a network methodology enables the application of professional judgment by engagement teams, promotes consistency in audit processes and procedures and helps to avoid interpretive issues across member firms of a network. Methodology must be updated regularly to reflect new standards, emerging auditing issues and matters, and implementation experiences and to respond to external and internal inspection results.

⁵ Section 1.8.3 of the Framework

⁶ Section 1.7.2 of the Framework

⁷ Section 1.8.2 of the Framework

We believe a methodology that provides interpretative application of the ISAs, and establishes additional requirements beyond those in the ISAs, contributes to audit quality. However, the Framework suggests that a “highly prescriptive” methodology will have negative implications on audit quality. We believe the discussion would be more balanced if the Framework more fully discussed the benefits of audit firms developing and updating their methodologies, such as those described above. In addition, it would help to further emphasize that some level of prescription, such as required procedures or documentation, can help to improve audit quality through greater consistency in approaches and the documentation of key aspects of the audit approach and auditor judgments.

Education and training - The Framework describes the training provided to auditors by both the profession and the audit firms,⁸ but we observe that it is discussed with a narrow lens and describes conventional topics. The profession needs to evolve to keep pace with the growing sophistication of the companies that we audit, which results in increasingly complex accounting and auditing standards. This rapid change demands the use of new methods and technologies to deliver training in a manner that can be quickly absorbed and applied by auditors. Additionally, training should emphasize the importance of new approaches to analyzing the vast amounts of data encountered in the digital age and further develop critical thinking skills to identify issues, trends and anomalies in this data.

2. 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?

We agree that the primary responsibility for performing quality audits rests with the auditor, but is best achieved when other participants in the financial reporting supply chain support the process. Although we have identified some additional areas to consider and additional suggestions for clarification or emphasis in our response to Question #1, we believe the Framework describes the significant elements of audit quality and identifies the effective interactions necessary among key stakeholders to best achieve audit quality.

Consistent with our comments above, to provide more balance to the Framework, we recommend that the IAASB more fully develop the roles and responsibilities that stakeholders other than auditors and the audit profession have with respect to audit quality. This would emphasize their importance and influence in achieving audit quality. We recognize that there is no single, international governing body for these stakeholders, but believe there is merit to establishing general guidelines and expectations that can help to facilitate dialogue among all stakeholders regarding ways to contribute to improving audit quality, both individually and collectively.

These guidelines could parallel those relating to the auditor and the auditing profession by suggesting the key elements that, for example, most directly relate to the responsibilities of management and those charged with governance with respect to the financial reporting process. Guidelines related to audit committees might include the importance of a corporate governance structure that empowers a committee to effectively discharge its oversight responsibilities and is comprised of members independent of the entity who have the appropriate level of expertise.

⁸ Section 1.5.4 of the Framework

Additionally, while the Framework recognizes the importance of interactions between auditors and regulators, we believe this interdependency could be more thoroughly developed. Specifically, we believe the presence of robust financial, prudential and audit regulators who actively engage with the auditors to respond to emerging issues would enhance audit quality.

3. 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 maximize its value to you?

We will consider use of the Framework in a manner consistent with the IAASB's vision, particularly with respect to our ongoing efforts to increase the dialogue among stakeholders and explore ways to improve audit quality. We believe a commitment to audit quality requires continuous improvement and, therefore, we may use the Framework as a point of reference in the existing and on-going design and operation of our system of quality control and to consider further the appropriate level of interaction with other stakeholders involved in financial reporting.

To further promote the Framework, we encourage the IAASB to further engage in discussions with the various stakeholders on how their respective responsibilities and contributions to the Framework could best be achieved.

4. 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?

The development of the Framework is a step in considering the complex and important topic of audit quality. We agree and support that more needs to be done, by all stakeholders, to continually improve audit quality. The Areas to Explore will require integrated efforts by many stakeholders that will need to be balanced against competing priorities. Therefore, we believe the following Areas to Explore proposed in Appendix 1 of the Framework should be given priority:

Evaluating audit inspection activities - We concur with the IAASB that there is value in reviewing independent audit inspection practices and exploring whether greater international harmonization could be achieved. Recognizing that the ISAs are modified to take account of, or are supplemented by, additional national requirements, the International Federation of Accountants encourages its member bodies to adopt and implement ISAs in their jurisdictions. As much of the auditing profession effectively operates under the ISAs, we believe the use of international guidelines, modified as necessary, in inspection activities may result in more consistent inspection results and actions across audit firms. This is also in the public interest as it may improve users' understanding and comparability of inspection findings and ratings.

Improving the Auditor's Report - As conveyed in our response to the IAASB's *Invitation to Comment: Improving the Auditor's Report*, we strongly support meaningful change to increase the usefulness and informational value of the auditor's report. Among other things, we support the concept of including key audit matters in the auditor's report and believe that key audit matters should require auditors to highlight matters that, in the auditor's judgment, are likely to be most important to users' understanding of the financial statements and draw attention to management's disclosures of those matters. For the matters highlighted, the auditor should indicate why the matter is important to users' understanding of the audited financial statements.

Enhancing the role of audit committees - The independence, size, expertise and responsibilities of audit committees vary around the world. While there are, of course, a number of highly effective audit committees, there is room to strengthen others and promote leading practices.

Engaged, independent audit committees that effectively discharge their oversight responsibilities and challenge both the auditor and management are best suited to contribute to audit quality.

We support the expansion of the types of matters required to be communicated, such as those described in PCAOB Auditing Standard No. 16 (AS16), *Communications with audit committees*, which is intended to enhance the relevance, timeliness and quality of communications between the auditor and audit committees. AS16 modifies and expands existing communication requirements and in many cases, requires the auditor to communicate more information about topics they already discuss with audit committees. For example, the communication requirements have been expanded to include additional details regarding the audit strategy, such as the timing of the audit, the identification of significant risks and audit response, and the use of internal auditors or others.

To enhance the transparency of the audit committee oversight process of auditors, we believe that shareholders should receive a report from the audit committee setting forth the steps it has taken to assure itself that the auditor is the right auditor for the company, i.e., that the auditor is both independent and effective.⁹ More transparency to shareholders about audit quality and auditor selection will increase shareholder involvement and promote investor confidence in auditor effectiveness and independence.

Additional Area to Explore –We believe it is important to have a meaningful debate about the role and relevance of the audit and potential audit reform. In our view, the focus should be on improving the quality of financial reporting and the audit, as well as, developing proactive mechanisms to maintain and enhance audit quality in the rapidly changing global environment. There is also merit in addressing the issues associated with maintaining the quality of financial reporting in an increasingly complex, digital age where both preparers and auditors are often overwhelmed with data. It is in the public interest to develop an integrated approach to tackling these issues but will require support from preparers in providing quality, complete data in a useable format, the development of high quality auditing standards that can be effectively implemented, and increased investments by audit firms in the tools and training necessary to respond to the associated risks.

We would be pleased to discuss our comments with members of the IAASB or its staff. If you wish to do so, please contact Karen M. Golz, Global Vice Chair, Global Professional Practice (karen.golz@eyg.ey.com).

Yours sincerely,

Ernst + Young Global Limited

⁹ Refer to Ernst & Young's response to Revisions to the UK Corporate Governance Code and Guidance on Audit Committees – proposals on audit tendering